2007 Annual Report

Building, protecting and valuing

your heritage

La Capitale
Civil Service Mutual

Celebrate Quebec City

QUÉBEC 1608 - 2008

This year, people will be coming from everywhere to celebrate Quebec City's 400th anniversary.

La Capitale will be joining them in the festivities, participating in a host of activities along with its employees.

Happy birthday, Quebec City!

Les photographes Kedl

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Key Facts and Figures

The history of La Capitale, since its inception in 1940, is not unlike that of its hometown Quebec City, which was founded in 1608. Both La Capitale and the city of Quebec pay tribute to the men and women whose community commitment and contribution to the growth and development of these institutions serve as an example for future generations.

members

La Capitale had **213,942 loyal Mutual members** in 2007, a far cry from the handful of individuals who pioneered the company's creation over 67 years ago.

equity

Members' equity increased from **$177.8** million at the end of 2002 to reach **$445.4 million in 2007**.

profits

Consolidated net income after non-controlling interests was **$65.8 million as at December 31, 2007**, compared to $23 million in 2002.

Net profits are up:

> Life and Health Insurance sector: **$42 million**

> Property and Casualty Insurance sector: **$26 million**

assets

From **$1.5 billion** in 2002, total assets have grown, reaching **$2.8 billion** at the end of 2007.

dividends

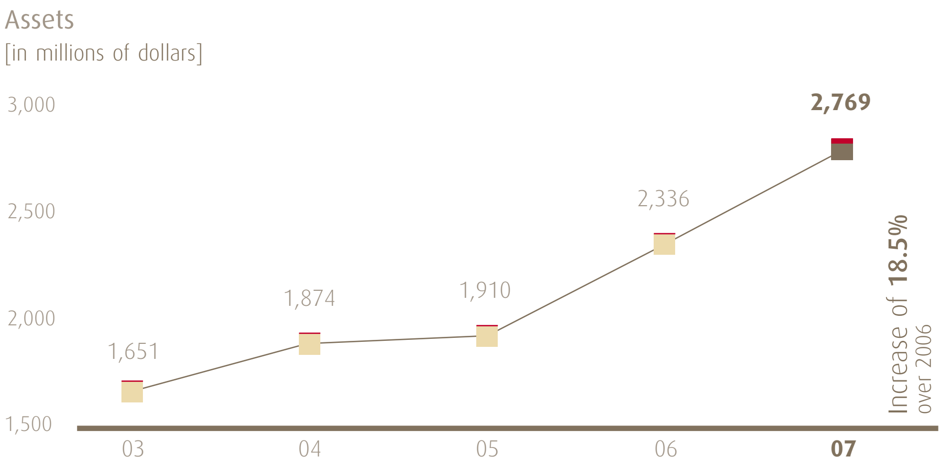
From the **$9.2 million** paid out to Mutual members in 2002, dividends increased to reach **$12.1 million** at the end of 2007.

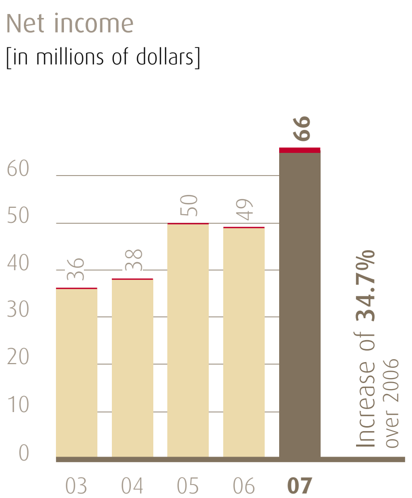
employees

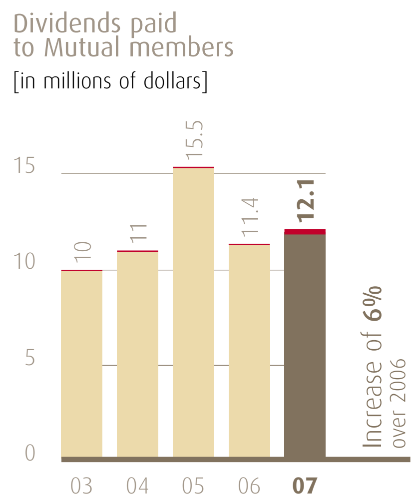
La Capitale plays a pivotal role in the provincial economy with **2,226 employees across Canada**.

acquisition

Agreement between two mutuals: Acquisition of **50% of the shares** of Promutuel Life.







Corporate Structure

La Capitale
Civil Service Mutual

La Capitale
Financial Group

La Capitale
Financial Management

La Capitale
Civil Service Insurer

La Capitale
Financial Services

AGA
Financial Group

La Capitale
Insurance and
Financial Services

La Capitale
General Insurance

L'Unique
General Insurance

La Capitale
MFQ Real Estate
Management

Penncorp
Life Insurance Company

Jean-Yves Dupéré
Chairman of the Board and
Chief Executive Officer

Commitment: At the heart of all we do

As Canadians and international visitors converge upon Quebec City to celebrate the city's 400th anniversary, what better occasion for La Capitale to proudly stand by its commitment to the values that have remained as important as ever throughout the centuries and which characterize the mutualist way of thinking. The company, with its rich history, has once again posted excellent results, which can be seen here in the pages of this Annual Report. Our Mutual has once again displayed its flair for financial efficiency and social commitment.

The 2000s: Under the sign of mutualism and commitment

When I took over as Chairman of the Board and Chief Executive Officer in January 2003, a strategic plan had already been put into place and the Board of Directors had already started taking the company in a new direction that served to reinforce our status as a mutual.

By 2004, the Mutual's strategic plan had homed in on two key concepts. The first, mutualism, is founded upon values of democracy, putting people first, mutual aid and solidarity, intergenerational balance and enrichment and valuing the role of public administration employees. The second key concept is our sound business sense. This concept is related to such values as integrity, profitability, quality of service, controlled growth and employee satisfaction.

During the same period, as part of the review of its corporate governance rules, La Capitale revised all of its policies concerning compliance and ethics, enabling it to adopt best corporate governance practices that would ensure that its corporate governance meets the highest recognized requirements in terms of integrity, equity and transparency.

In 2005—the 65th anniversary of the founding of the *Mutuelle des employés civils*—La Capitale reconfirmed its commitment to the social economy to which it is such a key contributor. With its unique position as a Mutual that belongs to public service employees, making it one-of-a-kind in Canada, it has already made the concept of sustainable development, which hinges on strategies that take into account the economic, social and environmental impacts of its activities, one of its core values. In 2006, having already established sustainable business relationships with desirable partners, it broadened the scope of its long-term partnership agreements, particularly with groups and associations from the public, parapublic and peripublic sectors.

2006 also saw the Board of Directors adopt a risk management policy covering all of the company's activities. A long-term strategic plan (2010-2020) simultaneously confirmed that La Capitale's Mutual members—our public service employees—will remain at the heart of everything it does, and that its every action will be taken with this, and them, in mind.

Vision, values, and excellence

Our vision took a radical new direction during these years. In 2003, the Mutual launched its first ever major awareness campaign. Its goal was clear: To highlight the importance and the value of the role of public service employees by paying homage to the men and women who work together for the well-being of us all. It also launched an ad campaign to thank all of the individuals who work so hard to make our province a better place, and this campaign was coupled with activities intended to increase visibility and promote its status as a mutual and its commitment to fostering a sense of pride among public service employees. In keeping with this sense of pride, and as a way to thank them for their loyalty, the Mutual began offering accidental death insurance, *Maxi-Privilege*, to all active and retired public service employees with a La Capitale General Insurance contract, assuming all of the premiums itself. As a way to further recognize its close ties with public sector employees, in 2004 it changed its name to La Capitale Civil Service Mutual.

La Capitale General Insurance twice received the title of *Best employer of the year* (2003, 2006), thanks to employees' voluntary participation in a comprehensive survey conducted by the consulting firm Watson Wyatt. In June 2007, as part of its pioneering work on the claims adjudication process for road adjusters, it won the *Fédération de l'informatique du Québec*'s *OCTAS* award in the "Organizational Process Transformation" category for organizations with 250 employees or more. I would like to commend the team's excellent work and creativity on this project.

In May 2006, La Capitale was proud to become a major partner of the FRESIQ nursing science research foundation, offering $100,000 in financial support over five years. This partnership for excellence forms another bond between our group and the *École nationale d'administration publique*—a relationship that has existed since the creation, in 2005, of the La Capitale Research Chair for Public Sector Leadership—to which we are offering financial support of $250,000 over five years.

These honours and corporate actions testify to La Capitale's commitment to highlighting the contributions of the men and women who give their 100% to benefit us all. We cannot honour them enough. Quebec's Premier expressed the same opinion in November 2007, during the ceremony for the Awards of Excellence from the Institute of Public Administration—another La Capitale partner.

Social conscience and intergenerational projects

In 2007, La Capitale took the lead in promoting road safety by teaming up with a company named Guardian to support its *Apprentice* program for young drivers. This program involves a pact between parents and children to drive safely at all times. And this pledge is a particularly important one, given the alarming statistics concerning accidents involving young drivers between the ages of 16 and 24.

From its involvement in humanitarian causes (such as the Southeast Asian tsunami), to its environmental contributions, including insurance discounts for *LEED*[1]-certified buildings and hybrid vehicles, to its nearly 20-year involvement with the *Ministère de la Sécurité publique*'s fire safety campaign, the La Capitale family demonstrated its social conscience once again in 2007—a social conscience that guides the decisions made by Board directors, managers and employees!

In addition, 2006 saw the creation of a special fund for pilot projects intended to help retired members of the AQRP (Quebec's association of public and parapublic service retirees) remain independent.

Partnering and restructuring

Recent years have been marked by major acquisitions, including L'Unique, Orleans, AGA Financial Group, Penncorp Life Insurance Company and a major business partnership between two mutual insurance companies through Promutuel Life. The *Good for you!* program, designed to promote health and the benefits of exercise, was launched to great acclaim. In 2007, a training session on mutual principles and values was designed and delivered to all employees. Several partnerships were renewed, including the Young Explorers program, and collaborative initiatives were maintained with management in the education sector.

A new mortgage product was launched in 2007: the *Worryproof Homebuyer's Package*. This new product enables homeowners and first-time buyers to lock into a 5-year fixed rate mortgage and to enjoy frozen home insurance premiums for that same period, even if they make one or more claims. The same year, La Capitale entered the arena of recreational vehicles, launching a range of new *RV Solutions Insurance®* products.

Last July, La Capitale held a symbolic ground-breaking ceremony for what is aiming to be Quebec City's first *LEED*-certified office building, The Delta 3, in the city's Sainte-Foy district. La Capitale has chosen building standards that could make it eligible for "Gold" certification, which recognizes environmentally sound development of a site in the following areas: water efficiency, energy efficiency, material selection, indoor environmental quality and design innovation. In the wake of this impressive construction project and to encourage the use of public transport, La Capitale is integrating a heated bus shelter for public transit users into its construction plans, once again confirming its social involvement and commitment to the principles of sustainable development. Negotiations and construction work to expand its Head Office continued in 2007 to ensure that the new building will fit seamlessly into the Parliament Hill landscape, while reflecting, in both design and material, the architecture and the history of Quebec City.

1 Leadership in Energy and Environmental Design

An economic context to watch

Despite the solid performance of the global economy, a U.S. recession is expected this year, which would result in a more generalized slowdown of the world economy in 2009. Europe is excepted from this prognosis, as it has a distinct economic cycle and fewer excesses to correct.

Things bode somewhat better for the future of the Canadian economy, as compared to its southern neighbour. Specialists anticipate a weakened economy, but not to the degree seen in the U.S. This is due in large part to healthier household balance sheets and a real-estate market with fewer excesses to be corrected. Certain international elements could also influence Canada's economic situation. The Kyoto Protocol, sustainable development, terrorist threats and the war on terror could also negatively impact expected growth.

Financial results that speak for themselves

La Capitale Civil Service Mutual's 2007 financial results greatly exceeded our expectations. A confluence of unexpected and undreamed-of circumstances led to spectacular results. However, the economic forecast for 2008 may serve to counteract this.

In 2007, the assets of La Capitale Civil Service Mutual rose to nearly $2.8 billion, with total income of $1.1 billion, for an increase of 22.6% over the previous year. The Mutual posted net income of $65.8 million, an increase of 34.7% over 2006. Members' equity reached $445.4 million, for a return of 18.8%, with $12.1 million being paid out to Mutual members with participating policies.

As part of a five-year retrospective, at the end of 2007, La Capitale Civil Service Mutual's average annual growth was 12.2% of total sales—an increase from $613 million to $1.09 billion. During this same period, Mutual members' equity more than doubled to $445.4 million. This performance can be attributed to the dedication and energy of everyone working for the La Capitale family.

The Life and Health Insurance sector saw additional profits of approximately $8.3 million over 2006, despite major investments in various operational sectors and a major increase in the number of insureds, a number that rose from 129,500 in 2006 to 133,600 in 2007. These results are mainly due to an exceptional performance in terms of administrative management, investments and the tireless work of our financial security advisors. The excellent performance of Penncorp—the Toronto-based subsidiary we acquired in 2006, whose profits have contributed to these results—also deserves credit.

The growth and profitability of our Property and Casualty Insurance sector are, once again, right on target. Posted results were even better than in 2006, a sign that in today's highly competitive market, the Mutual is clearly making a name for itself. Favourable market conditions coupled with prevention programs and our drive to innovate with new products and partnerships enabled this sector to post additional profits of approximately $11 million.

And in keeping with the directions of our 2003 strategic plan, the Corp-Rate company was sold during the course of the year.

Today, La Capitale Civil Service Mutual represents some 213,942 Mutual members who are eligible to exercise their rights, and 2,226 employees who are passionate about the mutualist mission of our extended family!

Movements

In pursuing the goal that it set for itself in 2003 to harmonize the different elements of its corporate structure and to meet its needs to grow the company and prepare for future challenges, La Capitale Financial Group announced last December that it would be restructuring across the various subsidiaries of the group. This restructuring is in line with La Capitale's policy on controlled growth across Canada and promotes knowledge-sharing between executives and the next generation. La Capitale Financial Group is responsible for ensuring that the Mutual's directions are implemented, while promoting synergy between the subsidiaries.

Together, we're making history

Throughout its history, our Mutual, founded more than 67 years ago by a group of civil servants, has based its actions on one key core value: commitment. This past year reflects how firmly the principles of solidarity, integrity, equity and transparency are entrenched in everything we do, and how these qualities have shaped our corporate culture. In 2007, the mobilization, experience, professionalism and motivation of the staff, managers, and senior management of La Capitale and its subsidiaries have once again carried us to peak levels of performance and involvement. I'd like to take this opportunity to offer my sincere thanks to all of our employees who give their all each and every day to produce such exceptional results. I'd also like to add how much I appreciate the unwavering support and judicious advice of the members of our various Boards of Directors. To all of the members of our extended family, let me just say, "Thank you."

It is clear to me that our dedication and excellent work, coupled with the loyalty of our Mutual members, whom I thank, compel us to pursue the noble mission that is mutualism, whose history is written in these very pages. The ties that bind us only serve to increase our commitment to act at all times with the utmost discipline, humanity, and transparency, as together we continue to write new chapters of a shared destiny, at the heart of our special city that marries History and Innovation: Quebec City.

Jean-Yves Dupéré
Chairman of the Board and Chief Executive Officer

Board of **Directors**

1. **Jean-Yves Dupéré**
   Chairman of the Board and
   Chief Executive Officer
2. **Jacquelin Bergeron**
   Vice-Chairman
3. **Guy Bouchard**
4. **Dominique Dubuc**
5. **Martial Fillion**
6. **Roland Guérin**
7. **François Jutras**
8. **Danielle Poiré**
9. **Louise Potvin**
10. **Sophie Proulx**
11. **René Rouleau**

Governance

In recent years, La Capitale has consolidated its rules of corporate governance. This process entailed a consolidation of the core values, policies, standards and guidelines that the Board directors and officers of the Mutual and its subsidiaries must follow.

Now, more than ever, our corporate governance rules meet the highest possible requirements in terms of integrity, equity and transparency. Updating our compliance and ethics policies will ensure that La Capitale continues to be governed as soundly and efficiently as possible.

The Mutual's corporate governance rules have also served to clarify the roles of the Board of Directors and its committees, clearly delineating their respective responsibilities. These principles of governance have also resulted in a review of the Code of Conduct and Ethics, which sets out the requirements and constraints that La Capitale employees must follow in the course of their work.

Board of Directors

Eleven members sit on the Board to ensure an even geographic and professional representation, while encouraging the involvement of various areas of the public sector. This makeup also ensures that its directors are fairly represented on the Board's various committees.

As the administrator and agent of La Capitale's mutual members, the Board of Directors has two primary roles: To define the company's mission and strategic plan and to appoint the Chief Executive Officer, who is responsible for carrying out this mission. In general, the Board ensures that the company is run soundly and governed efficiently. It guides the company's socioeconomic and commercial activities, as well as its internal affairs, with a view to maintaining a healthy balance between the interests of Mutual members in the short-, medium- and long-term. In this respect, it oversees senior management to ensure that business is conducted in accordance with the directions the Board has put forward. Finally, the Board of Directors ensures that La Capitale Civil Service Mutual plays a social role through its mutualist values and the contribution of its various representatives.

Committees of the Board of Directors

The various committees of the Board enable responsibilities to be shared and let the Board devote the necessary resources to specific areas or to any issues that may arise.

The committees present regular reports to the Board of Directors about their specific mandates.

> **Human Resources and Governance Committee**
The Human Resources and Governance Committee is responsible for the general supervision and enforcement of policies with regard to human resources at La Capitale Civil Service Mutual and its subsidiaries. It ensures that the corporate governance rules remain up-to-date and that the Board complies with these principles. Finally, it proposes various policies and strategic directions to the various boards and sets executive salaries.

> **Audit Committee**

Pursuant to the applicable legislation, audit committees have been set up at all of the insurance companies associated with La Capitale Civil Service Mutual. At least one member of the Mutual's Board of Directors sits on each committee, in order to ensure that the company's overall vision is upheld.

The committee's mandate is to help the Board fulfill its oversight responsibilities towards Mutual members and shareholders concerning financial disclosures, internal controls, the evaluation of risks to the company, IT systems security and compliance with the laws and regulations of the insurance industry.

The audit committees are responsible for both the internal and external audits of the Mutual's subsidiaries.

> **Ethics Committee**

Pursuant to the applicable legislation, such committees have been set up at each of La Capitale's insurance companies. In addition, La Capitale Civil Service Mutual has its own committee, which has jurisdiction over all of its subsidiaries operating outside the field of insurance.

The Ethics Committee develops, adopts and implements appropriate regulations so that legislative and regulatory provisions can be applied. As such, it certifies that the conduct of Board directors, managers and employees complies with business ethics and the company's Code of Conduct and Ethics.

> **Pension Committee**

The Pension Committee is responsible for and administers the pension plan. In this role, it sees that the assets held in the pension fund are managed soundly. It makes investment decisions and decides how benefits will be paid out, while fulfilling its obligations towards participants and beneficiaries.

The same employer representatives sit on each pension committee; only the plan representatives and the independent members vary by committee.

> **Nomination Committee**

The Nomination Committee verifies whether candidates are eligible to sit on the Board of Directors and ensures that nomination formalities are respected. It accepts or rejects each nomination and submits a report at the Annual General Meeting. The committee is also responsible for ruling on cases of contested eligibility raised by candidates or their representatives.

La Capitale makes these practices a real priority, translating a commitment to sound corporate governance into continuous improvement of its performance. These practices are firmly in line with its mutualist convictions, meeting and even surpassing regulatory standards.

These measures and many others have contributed to the longevity of La Capitale Civil Service Mutual. Its Board directors, managers and employees are fully committed to these principles, and this commitment ensures that they act for the common good and for the protection of the members of the Mutual.

Building
your heritage

Following the fierce fires of 1866, the citizens of Quebec did not hesitate to shoulder the burden before them and rose to the challenge of rebuilding their beloved city.

Its past, present and future intricately interwoven with the history of the province's public service, La Capitale has come a long way since its creation in 1940.

La Capitale is now a key player in the financial universe and the heritage built in Quebec City.

Les photographes Kedl

Commitment:
At the heart of our story

In its valiant and determined pursuit of its mission—to serve members of the public service and their families—mutual aid and solidarity remain at the heart of everything La Capitale does. Its history is a testament to this, and that history will forever be entwined with the history of Quebec City.

The foundations of the mutualist movement in Quebec

Before the cooperative movement found its footing, the first mutuals were already there. They were formed to meet the needs of craft guilds that wanted to provide financial relief to their members in times of need through a pooling of funds. The first of these in Lower Canada appeared in 1789. The Quebec Provident, Benevolent, and Friendly Society had a unique mission: To protect small English artisans and merchants in Quebec City in the event of illness or death. It wasn't until the second half of the 19th century that true fraternal benefit societies were created, however, particularly among the working class.

A unique economic context

From 1790 to 1880, Quebec City's port was bustling and the lumber trade upon which the economy was based stretched out along the river. A vast cottage industry sprung up, with working-class neighbourhoods adjoining the lands of well-heeled merchants. By the mid-19th century, the city's land had been divided into parishes. These thriving times were followed by a leaner period, due to the decline of the lumber trade and shipbuilding industries. Thousands of people left the city, including hundreds of civil servants who made their way to Ottawa, which became the nation's capital in 1867. A large portion of the merchant elite also left Quebec City for Montreal. But the city survived, thanks to the broadening of its industrial base, particularly in the areas of shoe manufacturers and tanneries, and with the advent of the industrial era with the mechanization of manufacturing, which jump-started the city's economy once more.

1900-1940
Origins of the Mutuelle des employés civils

In Quebec City, the first half of the 20th century was marked by strong urban growth and the expansion of city lands, due primarily to a rural exodus to urban centres and to several annexations (Saint-Malo in 1908, Limoilou in 1909, Ville Montcalm in 1913). As roadways became more common, the first suburbs were born. Meanwhile, workers from the nearby countryside were being drawn to the capital, whose industrial growth carried with it the promise of economic development. Founded in Quebec City in 1925, the *Association sportive des employés civils* would become the *Association des employés civils* (AEC)[1] in 1938, and would serve as the foundation of the *Caisse populaire des employés civils*, formed in 1939, and the *Mutuelle des employés civils* (MEC), formed in 1940.

In 1940, life in the civil (or public) service was characterized by low pay, a lack of job security and lack of access to insurance services. Members of the AEC, whose Board of Directors was chaired by Arthur Savard, decided to found a mutual funeral benefit fund. Contributions were mandatory and members received certificates. Through the program, a portion of members' contributions was set aside to set up a fund to provide benefits of \$75 or \$150 to the legal heirs upon the death of the member or the member's spouse.[2] The idea of founding a true fraternal benefit society caught on and in February 1941, the government granted legal status to the project that would officially become the *Mutuelle des employés civils* (MEC). From its nascent years to the present day, the Mutual has enjoyed a presence at the worksites of public service employees, offering them the opportunity to make their payments through payroll deductions. By choosing mutualism, the founders of the MEC, all of whom were from the senior public service of the era, created the first voluntary partnership that guaranteed members permanent solidarity and representation, the ability to retain control over their institution and to ensure their own well-being, while reinforcing their commitment to the place they called home. Such is the story of the La Capitale family, whose roots are so deeply entrenched in our common History!

The 1940s

Social conscience and growth

In the context of World War II and the Canadian government's Victory Bond campaign, the MEC acquired six certificates for a total of $6,000, doing its own part for the war effort (1945). The 1940s saw the Quebec City area become a true urban centre (the development of the Saint-Thomas-d'Aquin and Saint-Yves districts; the founding of the city of Sainte-Foy). In 1946, the city purchased the Saint-Malo war equipment plants and created the region's first industrial park. The second half of the 20th century, however, saw the city's economic focus turn towards the service, finance, insurance and commerce sectors. From its founding until 1947, the Mutual continued its mission as a mutual funeral benefit fund—a modest beginning, but a promising one. In 1947, its strength growing (assets of $12,253.17; 8,206 members), it decided to respond to other needs by creating a life insurance fund. 1947 also saw the first Mutual issue its first life insurance policies. From that time forward, the Mutual began using the services of representatives who were employed and paid by the government. In response to a request by the province's association of civil servants, which covered the greater Montreal area and wanted to take advantage of its programs, the Mutual expanded its services to the province's largest city in 1949.

The 1950s

Health, group insurance and a new status

Already deeply aware of the importance and value of communication methods, our mutual launched a newsletter: *La Mutuelle des employés civils*. In 1951, it created a health insurance policy together with the subsidiary of an American company (the Mutual Benefit Health and Accident Association), forming a partnership between the two mutual insurance companies. In 1954, it signed a contract with the *Commission des liqueurs de Montréal*, thereby launching its first group insurance plans. The rapidly growing *Mutuelle des employés civils* set up its first head office at 29 Sainte-Ursule Street. In 1955, it had a logo created for itself by Maurice Brodeur—an emblem proudly displaying the motto: *Sorgo et viresco* (growing and blossoming). The same year, it took over the province's *Mutuelle des fonctionnaires* (civil service mutual), based in Montreal, and the representatives held their first convention. In December, the Mutual and the Quebec Workmen's Compensation Commission signed a group insurance plan—a foreshadowing of what was to come. In 1958, the MEC changed its status from a fraternal benefit society to a mutual life insurance company.

The 1960s

Communications, valuing the role of employees, and performance

As the Quiet Revolution reigned, the 1960s in Quebec City were a time of suburban growth and the development of tourism and the public service industry, which was to become a much sought-after employment sector. While discovering what the telephone could offer, the Mutual was simultaneously focusing on the importance of communications, launching a newsletter in 1962 *(Savoir assurer c'est bien, bien assurer c'est mieux)*, and publishing the Mutual's first annual report in 1966. Eager to solicit peak performances from its representatives and to highlight the value of their work, the MEC launched two incentive programs with awards for *Virtue* and *Service*. Representatives received personality training designed by Wheeler Dupont, which focused on the importance of human relations and skills development, or the development of such qualities as honesty, loyalty, courage and discretion, coupled with the influence of physical health and personal health practices. Top-performing representatives' outstanding work was officially recognized, with their names being published in an *Honour Roll* in 1963. In 1962, the MEC also found a new home—where its Head Office still sits today—at the corner of Saint-Amable and De La Chevrotière streets, near the Parliament buildings on Parliament Hill. A name change in the spring of 1965 saw it become *La Mutuelle-Vie des Fonctionnaires du Québec*.

The 1970s

First general insurance subsidiary

In 1970, the Mutual set up a financial needs analysis tool to help civil servants and their families. The publication of the newsletter *Source* (1973) was a turning point in the history of its communications materials. Published until 2005, it would reflect three decades of its employees' culture and social lives! This period, characterized by an increasing union presence in Quebec's public sector, also saw many unions take out group insurance coverage.[3] The 1970s witnessed the advent of computers and their increasing popularity, the exploration of new market segments such as schools and hospitals, and the introduction of a 35-hour work week for employees. In response, in 1975, the Mutual created its first general insurance subsidiary: La Capitale General Insurance. This company specialized in automobile and property insurance, taking its place among the top direct insurers operating without brokerage intermediaries.

The 1980s
Under the sign of technology

The economic crisis of the early 1980s led to a significant decline in the number of jobs in the public sector in Quebec City. Economic diversification became vital and would lead to major investments in the high-tech industry. So it should come as no surprise that today, Quebec City and its surrounding area have become a technology hub, with more than 6,000 researchers and associates working in a network of more than 100 research centres, many of which have achieved international recognition.

Despite this difficult economic context, the Mutual experienced appreciable growth. In 1982, it changed its name to *La Mutuelle des Fonctionnaires du Québec* (MFQ). Subsidiaries were created around the same time: La Capitale MFQ Real Estate Management (1981); *Les Services financiers MFQ* (1985); and The Personal Life Insurance Corporation (1989). In 1983, the MFQ became the majority shareholder of the *Société Nationale de Fiducie*. Several major acquisitions followed, including Corp-Rate Card (1984), Lutex Leasing Inc. (1984) and the Parc des Braves residence (1984). This chain of events ended with an agreement between the Mutual and France's *Garantie Mutuelle des Fonctionnaires* (GMF) that made headlines in 1988. The agreement enabled it to acquire The Personal Insurance Company of Canada (1988) and gave rise to the Canami (now CanAssistance) international assistance service. That decade saw the launch of a regionalization[4] program, the Carte Capitale (a budget-discount card), and a new high-tech computer tool for the Mutual's financial services representatives (*Mallette Mire*). In 1987, the Sogefonds MFQ investment fund was set up, as was a holding company that helped the group break into new markets (*Corporation financière MFQ*). At the same time, La Capitale started making its general insurance products and services available to the Quebec population at large—a first step for the Mutual outside of its traditional market.

It was also during the 1980s that the first woman was appointed to the Mutual's Board of Directors: Jocelyne Baillargeon-Duval.

The 1990s
Consolidation, streamlining and networks

Many urban revitalization projects were undertaken in Quebec City during the 1990s (the Saint-Roch neighbourhood, Parliament Hill), and the city itself was honoured by UNESCO, being awarded the status of World Heritage City in 1985. In 1990, the Mutual built the Bon-Pasteur complex in partnership with the Quebec government and housing co-ops, and major transactions were undertaken (Maître courtier, Garage Michel Potvin). In 1991, the mutual company was converted into two legal entities: A limited liability insurance company and a mutual management corporation. It changed its name to the *Mutuelle des Fonctionnaires du Québec, corporation de gestion* (Quebec civil service mutual management corporation), bringing together all of its subsidiaries under a single holding company (MFQ Group) in 1992. That same year, a new subsidiary was created (MFQ Life Insurance Corporation) and the Mutual joined the *Société de coopération pour le développement international* (SOCODEVI), whose mission is to promote cooperative and mutual approaches to business in order to contribute to sustainable development in developing partner countries. La Capitale General Insurance launched an innovative legal assistance program for home insurance policyholders. In 1993, the economy was undergoing such shifts that it became necessary to streamline the company. As a result, the *Société nationale de Fiducie* was closed and The Personal Insurance Company of Canada was sold off. Meanwhile, electronic and computer communications were coming into full swing. The group took to the Web and new Internet protocols like a fish to water. The late 1990s saw the creation of a network of affiliated distribution agents working for La Capitale General Insurance (1996); the first edition of the *Pensez-y-bien!* magazine (1997); the opening of the Consolidated Billing Company in the U.S. (1998); and the creation, in 1999, of a subsidiary that brought representatives together and offered personal and retirement financial planning services (*MFQ Conseils*). The same year, La Capitale General Insurance introduced a new service: CAP Assistance.

The 2000s
Under the signs of mutualism and commitment

The 2000s have been a time of unity. Major municipal reforms brought a new amalgamated Quebec City into being,[5] and the Mutual united all of its subsidiaries under the name La Capitale, with the various companies adopting this moniker followed by the name of their business line.

Since its founding in 1940, La Capitale has always placed importance on its origins, its mutualist philosophy and its values. In recent years, more than ever before, it has shared its corporate vision with the world, stressing the importance of placing value on the work our public service employees do for all of us.

Strategic planning, governance and the reinforcement of its values and of the social economy were the key themes throughout the years 2003-2007. In line with its strategic directions and the changing face of its Mutual members, many positive changes have taken place. La Capitale's first gesture was to consolidate and focus on its primary activities, insurance and finance, by disposing of its subsidiaries Consolidated Billing Company (2004), Garage Michel Potvin and La Capitale Lutex Leasing (2005). And in accordance with its strategic plan, La Capitale acquired L'Unique General Insurance Company Inc. (2004), Orleans General Insurance Company (2005), AGA Financial Group (2005) and Penncorp Life Insurance Company (2006). Many new programs and products were also created and distributed to its Mutual members and clients during these years.

Now, history continues,
thanks to our Mutual members
and to the generations of the future.

1 Known today as the *Association des employées et employés du gouvernement du Québec* (AEGQ).

2 This $150 in today's (2007) dollars would represent $2,000. At the time, civil servants' salaries hovered around $800 to $1,000 per year.

3 Specifically the *Syndicat de la fonction publique du Québec* (SFPQ), the *Syndicat des professeurs de l'État du Québec* (SPEQ), the *Syndicat professionnel des médecins du gouvernement du Québec* (SPMGQ) and the *Fédération nationale des enseignants du Québec* (FNEQ).

4 Four offices opened in 1985, in Chicoutimi, Rimouski, Sherbrooke and Trois-Rivières; another nine would open in 1988.

5 The new Quebec City, whose territory now included the 13 cities of the *Communauté urbaine de Québec* (CUQ), founded in 1969, became official in January 2002.

La Capitale employees: An enduring sense of belonging

La Capitale owes the results presented in this annual report to the innovation, energy and skill demonstrated by each of its employees. This is why one of the company's fundamental business values is employee satisfaction.

At La Capitale, not only do we provide a stimulating environment with working conditions based on respect, recognition and responsibility (empowerment), we also promote two-way communication. As a result, there is a direct line of communication between senior management and employees, whose suggestions and comments are always welcome and worthy of consideration. This is why meetings are held by senior management with all employees on a regular basis.

Our employees

As at December 31, 2007, La Capitale had 2,226 employees working in the following core business divisions:

Life and Health Insurance Sector	1,191
Property and Casualty Insurance Sector	1,022
Related Services	13

In addition to these employees, 66 students worked for the company over the summer. These young people held a variety of different positions, not only gaining valuable work experience, but also learning what a mutual company is all about.

Training that's tailor-made

It is important for everyone who works for La Capitale to have the opportunity to expand their knowledge, develop new aptitudes and hone their interpersonal skills. This is all about creating an environment that promotes both personal and professional growth.

With the acquisition of Penncorp Life Insurance Company and the business development efforts outside Quebec, English language training programs are being offered to employees of our various companies. For the Life and Health Insurance sector, the courses are being offered to more than 80 individuals, while managers in the Property and Casualty Insurance sector have had access to similar courses since the fall of 2007.

A training session on mutualism was given to all employees in the Group in 2007. The goals of this session were primarily to explain the principles of mutualism by presenting its history, its differences, its characteristics, and its importance for the Quebec economy.

In 2007, 2.4% of total payroll was invested in training activities, well above the 1% standard set out by Quebec's *Act on skills development*.

La Capitale promotes the training and development of its human resources because it is an excellent way to maintain and improve the quality, effectiveness and efficiency of the services it provides to its Mutual members and clients. With this in mind, the company reimburses the cost of any job-related training courses offered outside the company.

Planning today for a better tomorrow

Like most institutions, La Capitale considers succession planning to be a key priority. In keeping with this priority, a succession and workforce planning program has been set up as a way of identifying the most vulnerable positions so that appropriate measures can be taken.

This is also the reason behind a restructuring initiative whereby seven experienced vice-presidents joined La Capitale Financial Group in keeping with a policy on controlled growth in Quebec and Canada, for the purpose of promoting a transfer of knowledge to the next generation.

Also in the spirit of a better tomorrow, a number of activities and programs were organized by the Health & Wellness committees, whose mandate is to promote healthy lifestyle habits, and the Eco-Committee, which aims to raise employee awareness about adopting environmentally-friendly practices in order to preserve our resources for future generations. These activities proved to be very popular with employees.

Mutual aid and solidarity: An intrinsic value at La Capitale

As an intrinsic part of the social economy, La Capitale exercises efficient, balanced control over its assets and redistributes a portion of these assets for mutual aid and solidarity in order to protect human capital and ensure a better quality of life.

This is why La Capitale advocates this value through its commitments, donations and sponsorships to the surrounding community.

Mutualism

In 2007, La Capitale continued to promote the cooperative and mutual movement through its active work with the *Conseil québécois de la coopération et de la mutualité* (CQCM). As part of this involvement, La Capitale Civil Service Mutual worked with various organizations including the *Fondation pour l'éducation à la coopération*, a foundation that promotes cooperative education, and took part in the round table sessions on cooperation organized by the CQCM.

It also strengthened its cooperative relationships through its continued partnership with the *Société coopérative pour le développement international* (SOCODEVI), a cooperative organization for international development.

Public service employees

In an ongoing effort to provide better service and assistance to the public service employees who make up its Mutual members, La Capitale renewed its commitments and signed new partnership agreements with a number of foundations associated with the Quebec public service, including the *Fondation du Cégep de Limoilou* college foundation, the *Fondation de l'Université du Québec à Trois-Rivières* university foundation, the *Fondation Asselin du Cégep de Jonquière* college foundation, the *Fondation du CHUS* hospital foundation, the *Fondation des Centres jeunesse du Bas-St-Laurent* youth centre foundation, and many others.

Through its various lines of business, La Capitale took part in a number of conferences and seminars that brought together employees from the public, parapublic and peripublic sectors as well as related associations.

Through its general insurance subsidiary, La Capitale has committed to donating $100,000 over five years to the *Fondation de recherche en sciences infirmières du Québec,* a nursing science research foundation. This is another way to recognize and encourage excellence among Quebec nurses.

With the goal of reaching as many members and institutions as possible, the company stepped up its efforts to recognize the role of public service employees in 2007. In this regard, it once again teamed up with various organizations, including the Quebec City Institute of Public Administration for the presentation of the public service awards of excellence, the *Centre hospitalier universitaire de Québec* hospital centre, whose Sirius awards recognize innovation in patient care and services, the *Association des cadres du gouvernement du Québec* government managers' association for its recognition awards gala, the Northern Quebec Health and Social Services Centre for the Everest awards, and several other organizations that are associated with the Quebec public service.

With the support of La Capitale, the La Capitale Chair in Leadership of the ENAP Public Administration University continued to research issues pertaining to leadership in the public sector and to circulate its results to the government community as a whole.

The Young Explorers program, which expanded its scope to cover a portion of the Montreal region and the Beauce-Appalaches area, once again received support from La Capitale in 2007. In a further commitment to young people, La Capitale gave 70 recycled computers from its own inventory to schools involved with the student sports association *Sport Étudiant Montréal*. This donation was made under the "3Rs of sports ethics" program, which promotes Respect for oneself, Respect for others and Responsibility for one's actions.

The community

La Capitale's top executives showed their commitment as patrons of honour to a number of charitable initiatives, including the *Fondation du Centre hospitalier Robert-Giffard* hospital foundation, the Red Cross, the *Fondation du Cégep de Sainte-Foy* and *Fondation du Cégep du Vieux Montréal* college foundations, the Quebec Cystic Fibrosis Association, the *Le Grand Chemin* foundation for young people in difficulty, and a few others.

In anticipation of the celebrations for the 400th anniversary of Quebec City, La Capitale has teamed up with urban education specialist *Société du Patrimoine urbain de Québec* to organize and present *Circuit-Québec*, a self-guided tour of Quebec City that offers a unique way to gain a better understanding of Quebec culture and architecture. It also continued to be a proud partner, for the third year, of Quebec City's International Festival of Military Bands.

On a cultural level, La Capitale actively contributed to the success of the Quebec Symphony Orchestra's ballroom gala fundraiser.

In 2007, La Capitale also sponsored the *Société du 400e anniversaire de Québec*, one of the organizations involved in the 400th anniversary of Quebec City, for the performance of a play entitled *Marie de l'Incarnation ou La déraison d'amour* by the *Théâtre du Trident* theatre company.

The various canvassing campaigns organized among La Capitale employees in 2007 were extremely successful, with some forty canvassers collecting close to $52,000 from their colleagues, including more than $44,300 for the United Way and over $7,800 for the Red Cross. In addition, over one hundred employees gave blood at the Blood Donor Clinic organized by *Héma-Québec*, and for the 18th year in a row, most of our employees gave generously to the *Noël du Bonheur* campaign for chronically ill individuals.

Sustainable development:
An investment in the future

Sustainable development has been a hot topic since it was first introduced in 1987. Now, 20 years later, it has become the meeting point between present and future, not only satisfying the needs of today, but also respecting those of future generations.

Sustainable development targets both the individual and the general population. It advocates respect for nature and equity among all peoples. All governments, institutions, companies and consumers are or will be impacted by this movement, which is quickly gaining momentum. It has become a matter of some urgency to equitably share the resources at our disposal.

Because the sustainable development philosophy is in keeping with some of the mutualist values adopted by La Capitale, management has made a point of introducing policies and taking concrete steps to promote this new way of thinking. The measures put in place, primarily in 2007, focus on three recognized aspects of sustainable development: social, economic and environmental.

Social

> Integrating our mutualist values of people first, mutual aid and solidarity into our subsidiaries' operations. Intergenerational balance and enrichment is a value that was integrated through regional mentoring projects between retired public service employees and young students.

> Setting up an *Eco-Committee* made up of close to 20 people at all levels who meet ten times a year. Its role is to develop an action plan and to put concrete measures in place based on the principles contained in the company's sustainable development policy. The committee's mandate is to raise awareness and mobilize all employees to take environmentally-friendly measures, both at work and at home, through such actions as recycling and saving energy and resources.

> Donating more than $1 million to Quebec foundations, associations and social organizations to improve quality of life in the community.

Economic

> Introducing a purchasing policy that promotes local products and environmentally-conscious suppliers who are strong advocates of sustainable development. 2007 was the first year of using paper containing 100% post-consumer recycled fibres and FSC certified envelopes (recycled fibres from well-managed forests).

> Offering a 15% discount on automobile insurance premiums through La Capitale General Insurance to all individuals with a hybrid vehicle.

> Offering a 15% discount on home insurance premiums for owners of *LEED*-certified constructions.

Environmental

- Introducing a corporate automobile policy that promotes the purchase of hybrid vehicles by increasing the car allowance when this type of vehicle is purchased. Conversely, company executives who drive vehicles with poor fuel economy will be penalized by having to pay a higher share of the cost.

- Issuing a challenge to all employees to reduce all in-house printing by 15% and updating our current printers with machines that automatically print double-sided.

- Carrying out a number of *ad hoc* initiatives in 2007:
  - Systematically handing out recycling bins to all employees
  - Giving every employee 3 environmentally-friendly shopping bags made in Quebec
  - Giving every employee an insulated, reusable mug during sustainable development awareness week

- Recycling all obsolete computer equipment and materials, as well as paper and ink cartridges, to reduce the amount of waste.

- Including a message at the bottom of all outgoing e-mails that says: “Do you really need to print this e-mail? If you do, think eco-friendly and print it double-sided.”

- Reducing greenhouse gases by promoting video and teleconferencing between our Quebec City, Montreal and Toronto offices in place of travelling.

- Saving energy outside business hours by turning off the lights and turning down the heat, ventilation and air conditioning in the building through programmable controls.

- Selling fair trade coffee in our buildings’ cafeterias and vending machines.

- Promoting public transportation by offering a payroll deduction payment option and delivering monthly passes to each user’s desk.

- Sending electronic documents whenever possible in place of hard copies.

- Aiming to achieve *LEED* certification in the construction of the Delta 3 building.

This year, as Quebec City celebrates its 400th anniversary, it’s time to pause and ask ourselves what the state of our planet will be in another 400 years. By asking each and every person to be a more responsible consumer, La Capitale is contributing to the quality of life of current and future generations.

Protecting your heritage

Quebec City's fortifications have served to protect its citizens well since 1812.

Like its hometown, La Capitale makes every effort to protect its members' wealth and that of future generations from the unexpected. The innovation, determination, passion and energy of its people are the drivers of its success.

David Cannon Studio

Consolidated **Financial Statements**

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Responsibility for Consolidated Financial Statements

The financial statements of La Capitale Civil Service Mutual have been prepared by management in accordance with Canadian generally accepted accounting principles and contain certain amounts based on management's best estimates and judgment.

In order to carry out its responsibilities with regard to the financial statements, management maintains internal control systems that provide reasonable assurance that transactions are duly authorized, that the financial records are reliable and that assets are safeguarded. These control systems are strengthened by the work of the internal auditor who conducts a periodic review of all of the key lines of business of the Mutual.

The Board of Directors of each insurance company names the Appointed Actuary, who is responsible for valuing policy liabilities in accordance with the standards of practice of the Canadian Institute of Actuaries and for expressing an opinion regarding their adequacy to meet all policyholder obligations of the companies at the balance sheet date. In addition, the Appointed Actuary is required each year to prepare a report for the Board of Directors on the capital adequacy of these companies.

The external auditors, Ernst & Young LLP, appointed by the members, carry out an independent audit of these consolidated financial statements in accordance with Canadian generally accepted audit standards and report on the fairness of the presentation of the consolidated financial statements of the Mutual.

Jean-Yves Dupéré
Chairman of the Board and Chief Executive Officer

Quebec City, March 17, 2008

Auditors' Report

To the Members of
La Capitale Civil Service Mutual,

We have audited the consolidated balance sheet of **La Capitale Civil Service Mutual** (the "Mutual") and the statement of net assets of the segregated fund as at December 31, 2007 and the consolidated statements of income, comprehensive income, retained earnings, accumulated other comprehensive income and cash flows and the statement of changes in net assets of the segregated fund for the year then ended. The financial statements are the responsibility of the Mutual's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Mutual and its segregated fund as at December 31, 2007 and the results of its operations, its cash flows and the change in net assets of its segregated fund for the year then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Chartered Accountants
Quebec City, Canada
February 11, 2008

Consolidated Balance Sheet

As at December 31 [in thousands of dollars]

ASSETS

	2007	2006
Investments		
Bonds *[notes 5 and 11]*	**$1,210,152**	$995,300
Mortgage loans *[notes 5 and 6]*	**479,522**	409,477
Stocks *[note 5]*	**350,482**	256,301
Real estate *[note 5]*	**126,808**	120,958
Cash and short-term deposits *[note 5]*	**100,405**	74,222
Policy loans *[note 5]*	**23,349**	21,864
Other investments *[notes 5 and 6]*	**20,142**	25,444
	$2,310,860	$1,903,566
Other items		
Premiums receivable	**$210,656**	$190,877
Goodwill *[notes 7 and 22]*	**62,012**	57,919
Intangible assets *[notes 8 and 22]*	**26,834**	31,319
Other assets *[note 9]*	**158,623**	151,970
	$458,125	$432,085
GENERAL FUND ASSETS	**$2,768,985**	$2,335,651
SEGREGATED FUND NET ASSETS	**$194,175**	$181,029

LIABILITIES

	2007	2006
Policy liabilities *[note 12]*		
Actuarial liabilities	**$1,601,324**	$1,245,917
Provisions for benefits incurred	**21,951**	18,320
Provisions for dividends and experience refunds	**18,218**	15,425
Policyholder amounts on deposit	**30,614**	29,842
	$1,672,107	$1,309,504
Other items		
Unearned premiums	**$249,625**	$225,296
Provision for claims and loss adjustment expenses *[note 13]*	**80,556**	74,809
Long-term debt *[note 14]*	**128**	6,442
Bank loans *[note 11]*	**15,000**	—
Accrued liabilities	**140,519**	146,171
Deferred net gains	**2,857**	75,301
Excess of outstanding cheques over cash	**1,487**	5,934
Other liabilities *[note 15]*	**64,274**	55,366
	$554,446	$589,319
Non-controlling interests	**$97,052**	$86,607
MEMBERS' EQUITY		
Retained earnings *[note 16]*	**$430,749**	$350,221
Accumulated other comprehensive income	**14,631**	—
	$445,380	$350,221
LIABILITIES AND MEMBERS' EQUITY	**$2,768,985**	$2,335,651
SEGREGATED FUND LIABILITIES	**$194,175**	$181,029

Commitments *[note 25]*
Contingencies *[note 26]*
Subsequent event *[note 27]*

See accompanying notes to consolidated financial statements

On behalf of the Board of Directors,

Jean-Yves Dupéré
Chairman of the Board and Chief Executive Officer

Jacquelin Bergeron
Vice-Chairman of the Board

Consolidated Statement of Income

For the year ended December 31 [in thousands of dollars]

	2007	2006
Revenues		
Insurance and annuity premiums	**$950,480**	$751,737
Net investment income *[note 19]*	**115,972**	115,360
Fees, commissions and royalties	**22,281**	21,026
Other	**1,089**	738
	$1,089,822	$888,861
Policy benefits and expenses		
Benefits and claims incurred	**$578,219**	$507,426
General expenses	**169,681**	142,956
Changes in policy liabilities *[note 12]*	**125,552**	79,938
Commissions	**62,271**	41,236
Premium taxes	**24,664**	20,443
Participating policyholder dividends	**12,108**	11,421
Non-controlling interests	**15,701**	8,666
Experience rating refunds	**5,158**	4,243
	$993,354	$816,329
Income before income taxes	**$96,468**	$72,532
Income taxes *[note 20]*	**30,663**	23,671
Net income	**$65,805**	$48,861

See accompanying notes to consolidated financial statements

Consolidated Statement of Comprehensive Income

For the year ended December 31 [in thousands of dollars]

	2007
Net income	$65,805
Other comprehensive income, net of taxes	
Unrealized gains and losses on available-for-sale financial assets, net of income taxes of $1,381	$(2,491)
Reclassification of realized gains and losses to net income, net of income taxes of $5,935	(13,198)
Non-controlling interests	2,034
	$(13,655)
Comprehensive income	$52,150

See accompanying notes to consolidated financial statements

Consolidated Statement of Retained Earnings

For the year ended December 31 [in thousands of dollars]

	2007	2006
Balance, beginning of year	$**350,221**	$301,360
Effect of new accounting standards *[note 2]*	**14,723**	—
Adjusted balance, beginning of year	$**364,944**	$301,360
Net income	**65,805**	48,861
Balance, end of year	$**430,749**	$350,221

See accompanying notes to consolidated financial statements

Consolidated Statement of Accumulated Other Comprehensive Income

For the year ended December 31 [in thousands of dollars]

	2007	2006
Balance, beginning of year	$—	$—
Effect of new accounting standards *[note 2]*	**28,286**	—
Other comprehensive income, net of taxes	(**13,655**)	—
Balance, end of year	$**14,631**	$—

See accompanying notes to consolidated financial statements

Consolidated Statement of Cash Flows

For the year ended December 31 [in thousands of dollars]

	2007	2006
OPERATING ACTIVITIES		
Net income	**$65,805**	$48,861
Adjustments for:		
Changes in actuarial liabilities	**125,552**	79,938
Changes in deferred net gains	**(2,539)**	(30 998)
Changes in net discounts	**(37,475)**	(27,637)
Changes in fair value of held-for-trading investments	**7,235**	—
Realized gains on available-for-sale assets	**(20,103)**	—
Amortization	**12,986**	17,915
Future income taxes	**15,831**	3,779
Non-controlling interests	**15,701**	8,666
Other items included in net income	**(202)**	(22,132)
	$182,791	$78,392
Net change in other items related to operating activities	**3,574**	18,545
Cash flows related to operating activities	**$186,365**	$96,937
INVESTING ACTIVITIES		
Purchase of stocks and bonds	**$(655,360)**	$(364,052)
Purchase of real estate	**(6,738)**	(1,977)
Issue of mortgage loans and advances	**(266,846)**	(443,160)
Stock and bond sales and maturities	**611,873**	471,414
Maturities, sales and repayments of mortgage loans and advances and securitization	**196,364**	383,928
Net acquisition of other investments and other assets	**(10,507)**	(9,889)
Business acquisitions *[note 22]*	**(20,203)**	(88,997)
Cash flows related to investing activities	**$(151,417)**	$(52,733)
FINANCING ACTIVITIES		
Net change in bank loans	**$15,000**	$—
Long-term debt	**282**	—
Repayment of balance of purchase price payable	**(8,779)**	(2,618)
Repayment of long-term debt	**(6,892)**	(256)
Change in non-controlling interests	**1,275**	(200)
Dividends paid to non-controlling shareholders	**(5,209)**	(3,509)
Cash flows related to financing activities	**$(4,323)**	$(6,583)
Net increase in cash and cash equivalents	**$30,625**	$37,621
Cash and cash equivalents, beginning of year	**68,004**	30,383
Cash and cash equivalents, end of year *[note 21]*	**$98,629**	$68,004
Supplementary information		
Interest paid	**$1,352**	$1,202
Income taxes paid	**$27,912**	$10,055

See accompanying notes to consolidated financial statements

Segregated Fund

Statement of Net Assets

For the year ended December 31 [in thousands of dollars]

	2007	2006
Assets		
Stocks	$79,011	$—
Bonds	74,287	72,144
Mutual funds	38,392	100,359
Cash and short-term investments	2,742	367
Other assets	663	8,293
	$195,095	$181,163
Liabilities		
Derivatives	$917	$—
Accrued liabilities	3	134
	$920	$134
Net assets	$194,175	$181,029

Statement of Changes in Net Assets

For the year ended December 31 [in thousands of dollars]

	2007	2006
Net assets, beginning of year	$181,029	$152,208
Additions		
Amounts received	13,061	17,017
Investment income	3,207	2,657
Realized net gains (losses)	(599)	229
Net increase in fair value	1,798	12,967
	$198,496	$185,078
Deductions		
Amounts paid	$3,859	$3,469
Investment expenses	462	580
	$4,321	$4,049
Net assets, end of year	$194,175	$181,029

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements

December 31, 2007
[in thousands of dollars]

1) Incorporating statute and nature of operations

La Capitale Civil Service Mutual, incorporated on December 6, 1991 under the *Act respecting the Québec Civil Servants Mutual Life*, is a mutual management corporation.

Its operations are carried out mainly in Canada through its subsidiaries and consist principally of life and health insurance and property and casualty insurance.

2) Changes in accounting policies

> **Financial instruments**

Effective January 1, 2007, the Mutual adopted the following sections of the Canadian Institute of Chartered Accountants (CICA) Handbook: Section 1530, Comprehensive Income, Section 3855, Financial Instruments – Recognition and Measurement, Section 3861, Financial Instruments – Disclosure and Presentation, Section 3865, Hedges, Section 4211, Life Insurance Enterprises – Specific Items, and Section 3251, Equity.

On June 1, 2007, the Mutual adopted Abstract 166, Accounting for Policy Choice for Transaction Costs, issued by the CICA Emerging Issues Committee.

Financial instruments – Recognition and measurement

Under this new standard, financial assets are classified in one of the following categories: available-for-sale, held-for-trading, held-to-maturity or loans and receivables. Financial liabilities are classified in one of the following categories: held-for-trading or other financial liabilities. Held-for-trading financial instruments are measured at their fair value, and gains and losses are recognized in net income. Available-for-sale financial instruments are measured at their fair value, and unrealized gains and losses are recognized in other comprehensive income items. Held-to-maturity financial assets, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest rate method. Under the new standard, the Mutual can designate any financial instrument as held-for-trading upon initial recognition.

As of January 1, 2007, the Mutual has classified all financial assets as held-for-trading, available-for-sale, or loans and receivables. Financial liabilities, with the exception of actuarial liabilities recognized in accordance with the provisions of Section 4211, have been classified as other liabilities.

Life insurance companies have elected to classify financial assets backing policy liabilities as held-for-trading assets, with the exception of mortgage loans, which are classified as loans and receivables. Changes in the fair value of these investments are included in net income.

Stocks and bonds that are not used to cover policy liabilities are classified as available-for-sale. Changes in the fair value of these investments, net of taxes, are presented in other comprehensive income items.

At the time of acquisition, financial instruments must be recorded at their fair value. Subsequent remeasurements will depend on the category in which the financial instrument was initially classified.

The fair value is based on bid prices in an active market. If the market is not active, the Mutual determines the fair value based on other observable market transactions in the same instrument or on another valuation technique whose variables include only observable market data.

The Mutual accounts for regular-way purchases and sales of financial assets using the settlement-date method. Under this method, any gains or losses between the transaction and settlement dates are recognized in net income for held-for-trading assets and in other comprehensive income for available-for-sale assets.

The transaction costs of held-for-trading and available-for-sale assets and liabilities are recognized in net income. Transaction costs of assets classified as loans and receivables are capitalized and amortized using the effective interest rate method.

Comprehensive income

Under the new standards, a new consolidated statement of comprehensive income must be presented and the amount of accumulated other comprehensive income must be reported as a separate line item in members' equity in the consolidated balance sheet. The consolidated statement of comprehensive income presents net income as well as unrealized gains and losses on available-for-sale financial assets, reclassification adjustments net of taxes, and non-controlling interests.

Hedges

This new standard presents the criteria for the application of hedge accounting and specifies how hedge accounting is applied under each of the permitted hedging strategies. The Mutual does not apply hedge accounting.

Life and health insurance companies

Under Section 4211, the calculation of actuarial liabilities is based on the carrying value of the assets required to secure them. Accordingly, the carrying value of actuarial liabilities has been modified to reflect changes resulting from the application of the new accounting standards for financial instruments.

Section 4211 signals the end of specific investment accounting rules for life and health insurance companies, except as they relate to real estate investments. Gains and losses on investments in stocks and bonds are no longer deferred and amortized and, consequently, the balance of net deferred gains as at January 1, 2007 has been charged to retained earnings, with the exception of those related to real estate investments.

Effect and adoption of these standards

On January 1, 2007, adjustments to held-for-trading financial instruments of subsidiaries were recognized in the opening balance of retained earnings. The effect is an increase of $14,723 in retained earnings.

Adjustments due to revaluation of financial assets classified as available-for-sale are recognized in the opening balance of accumulated other comprehensive income as of January 1, 2007. The effect is an increase in accumulated other comprehensive income of $28,286.

Prior period amounts have not been restated as a result of the new accounting standards. Consequently, the two fiscal years are not comparable.

		Members' Equity		
Effect of the new accounting standards on the opening balance	As at December 31, 2006	Retained earnings	Accumulated other comprehensive income	**As at January 1, 2007**
ASSETS				
Investments				
Bonds	$995,300	$184,000	$5,132	**$1,184,432**
Mortgage loans	409,477	(670)	—	**408,807**
Stocks	256,301	135	45,300	**301,736**
Real estate	120,958	—	—	**120,958**
Cash and short-term deposits	74,222	—	—	**74,222**
Policy loans	21,864	—	—	**21,864**
Other investments	25,444	—	—	**25,444**
	$1,903,566	$183,465	$50,432	**$2,137,463**
Other items	$432,085	$(11,450)	$(1,200)	**$419,435**
GENERAL FUND ASSETS	$2,335,651	$172,015	$49,232	**$2,556,898**

2) Changes in accounting policies [Cont'd]

> **Financial instruments [Cont'd]**

Effect and adoption of these standards [Cont'd]

Effect of the new accounting standards on the opening balance	As at December 31, 2006	Members' Equity: Retained earnings	Members' Equity: Accumulated other comprehensive income	As at January 1, 2007
LIABILITIES				
Policyholder liabilities				
Actuarial liabilities	$1,245,917	$235,215	$—	**$1,481,132**
Provisions for benefits incurred	18,320	—	—	**18 320**
Provisions for dividends and experience refunds	15,425	—	—	**15,425**
Policyholder amounts on deposit	29,842	—	—	**29,842**
	$1,309,504	$235,215	$—	**$1,544,719**
Other items				
Unearned premiums	$225,296	$—	$—	**$225,296**
Provision for claims and loss adjustment expenses	74,809	—	—	**74,809**
Long-term debt	6,442	—	—	**6,442**
Accrued liabilities	146,171	119	—	**146,290**
Deferred net gains	75,301	(72,127)	—	**3,174**
Excess of outstanding cheques over cash	5,934	—	—	**5,934**
Other liabilities	55,366	(9,797)	14,053	**59,622**
	$589,319	$(81,805)	$14,053	**$521,567**
Non-controlling interests	$86,607	$3,882	$6,893	**$97,382**
MEMBERS' EQUITY				
Retained earnings	$350,221	$14,723	$—	**$364,944**
Accumulated other comprehensive income	—	—	28,286	**28,286**
	$350,221	$14,723	$28,286	**$393,230**
LIABILITIES AND MEMBERS' EQUITY	$2,335,651	$172,015	$49,232	**$2,556,898**

Breakdown of investments by financial instrument category

	As at January 1, 2007				
	Held-for-trading	**Designated as held-for trading**	**Available-for-sale**	**Loans and receivables**	**Total**
Bonds	$—	**$963,329**	**$221,103**	$—	**$1,184,432**
Mortgage loans	—	—	—	**408,807**	**408,807**
Stocks	—	**88,227**	**213,509**	—	**301,736**
Cash and short-term deposits	**74,222**	—	—	—	**74,222**
Policy loans	—	—	—	**21,864**	**21,864**
Other investments	—	—	—	**25,444**	**25,444**
	$74,222	**$1,051,556**	**$434,612**	**$456,115**	**$2,016,505**

Investments in interests through which the Company exercises significant influence and in real estate are not included in the above table as they are not subject to Section 3855.

3) Accounting policies

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and the accounting policies related to each of the types of businesses included in the consolidation:

– life and health insurance companies
– property and casualty insurance companies

The accounting policies used to prepare these consolidated financial statements are summarized below.

> Basis of consolidation

The consolidated financial statements include the accounts of the Mutual and those of its subsidiaries. The investment in the joint venture has been accounted for using the proportionate consolidation method. Investments in companies where the Mutual exercises significant influence are accounted for using the equity method.

> Use of estimates

In preparing these financial statements, management must make estimates and assumptions that affect the amounts presented in the financial statements and the accompanying notes. Actual results may differ from these estimates. In management's opinion, the financial statements have been properly prepared using careful judgment within the reasonable limits of materiality and within the framework of the accounting policies summarized below.

> Revenue recognition

Life and health insurance and annuity premiums are recorded as revenues as they fall due under existing policies. Premiums are reported net of reinsurance amounts ceded to other insurers and amounts assumed from other insurers. As soon as premiums are recognized, actuarial liabilities are established to ensure matching between policy benefits and expenses related to these premiums.

Premiums written for property and casualty insurance are recorded as revenues over the term of each policy on a pro-rata basis. Unearned premiums in the balance sheet represent the share of premiums written pertaining to the unexpired term of outstanding policies. Premiums receivable include instalments of annual premiums written that are not yet due.

Investment income is accounted for on an accrual basis and reported net of investment expenses.

> Bonds

In 2007, pursuant to the adoption of the new standard on financial instruments, bonds are recorded at their fair value. Premiums and discounts are amortized using the effective interest rate method over the bond term and are recognized in net income. Unrealized gains and losses on held-for-trading and available-for-sale bonds are recognized in net income and comprehensive income respectively.

The fair value of bonds corresponds to the bid prices in an active market. In the absence of an active market, the Mutual determines the fair value using valuation techniques. These techniques include the use of available information on recent arm's length market transactions between knowledgeable and willing parties, the use of the current fair value of another financial instrument that is substantially identical and discounted cash flow analysis. Any permanent and material impairment in the value of these securities is charged to net income in the year in which the impairment occurs.

In 2006, bonds were reported at amortized cost. Premiums and discounts were amortized using the effective interest rate method over the remaining term to maturity of these investments. Any permanent and material impairment in the value of these securities was charged to income in the year in which the impairment occurred. Realized gains and losses on the disposal of these investments by the life and health insurance companies were deferred and amortized over the bonds' remaining term to maturity up to a maximum of 20 years. The gains and losses relating to the other companies were recognized directly through income.

3) Accounting policies [Cont'd]

> **Mortgage loans**

In 2007, pursuant to the adoption of the new standard on financial instruments, mortgage loans are recorded at their amortized cost. The amortized cost is the amount at which the mortgage loan is initially recognized less any principal repayments, plus or minus the accumulated amortization according to the effective interest rate method. Mortgage loans are measured at their fair value when they are initially disbursed.

The fair value of mortgage loans is determined using cash flows discounted at the market interest rate for loans with similar credit risk.

In 2006, mortgage loans were also reported at amortized cost. Realized gains and losses on the disposal of these investments were deferred and amortized over the average remaining term of the loans sold.

Impaired loans

Loans are classified as impaired if there is reasonable doubt as to the timely collection of the principal or interest or if a payment is over ninety days overdue. In addition, interest income is no longer recognized and the carrying amount of such loans is reduced to their estimated realizable amount.

The changes that subsequently occur in their estimated realizable value are reflected in the statement of income for the year.

> **Loan securitization**

A subsidiary of the Mutual securitizes pools of mortgage loans periodically by selling them to trusts that issue mortgage-backed securities to investors and retains responsibility for managing these loans.

In connection with securitization transactions, the subsidiary of the Mutual retains a portion of the future interest that will be paid by the borrower whose mortgage loan was sold. The subsidiary accounts for this future revenue, net of management fees, as retained interests. The fair value of retained interests is calculated using the discounted value of expected future cash flows based on assumptions concerning prepayments, management fees and discount rates. Retained interests are classified under loans and receivables and are amortized using the effective interest rate method.

Gains and losses arising from securitization are recorded to the extent of the excess or shortfall of the consideration received over the carrying amount allocated to the assets sold. These gains and losses are charged to income and included in net investment income.

In 2006, retained interests were amortized over the average term to maturity of loans sold. The gains and losses resulting from securitization transactions were deferred and amortized over the average term to maturity of loans sold. These gains and losses were included in net investment income.

> **Stocks**

Stocks include common shares, preferred shares, participating units and participating units in trading indices, and are recorded at fair value. In 2007, pursuant to the adoption of the new standard on financial instruments, gains and losses realized on stocks during the year are recognized in net income. Unrealized gains and losses on stocks classified as held-for-trading and available-for-sale are recognized in net income and comprehensive income, respectively.

The fair value of stocks corresponds to the bid prices in an active market. Any permanent and material impairment in the value of these securities is charged to income in the year in which the impairment occurs.

In 2006, common shares and participating units held by the life and health insurance companies were reported using the moving average market value method, whereby the carrying value was adjusted toward market value every year, by an amount equal to 15% of the difference between market value and carrying value. Realized gains and losses on the disposal of these investments were deferred and amortized on a declining balance basis at an annual rate of 15%. Participating units in trading indices held to match certain liabilities related to the universal life policy, guaranteed index investment certificates and index accounts were recorded at fair value.

Stocks held by the other companies were recorded at cost. Gains and losses arising from the disposal of these investments were recognized directly through income.

Any permanent and material impairment in the value of these securities was charged to income in the year in which the impairment occurred.

> **Real estate**

Real estate held by the life and health insurance companies for investing, operating and administrative purposes are accounted for using the moving average market value method, whereby the carrying value is adjusted toward market value every year, by an amount equal to 10% of the difference between market value and carrying value. Realized gains and losses on the disposal of properties are deferred and amortized on a declining balance basis at an annual rate of 10%.

Properties acquired through mortgage foreclosure are recorded at the lower of the loan balance and fair value net of selling expenses. Realized gains and losses on the disposal of such properties are recorded in income for the year.

Properties held by the other companies are recorded at amortized cost. Amortization is calculated mainly on a straight-line basis over a 40-year term. Gains and losses on the disposal of these properties are recognized through income for the year.

> **Policy loans**

In 2007, pursuant to the adoption of the new standard on financial instruments, policy loans are classified under loans and receivables. Policy loans are recorded at amortized cost and are fully secured by the cash surrender value of the insurance policies on which the loans are granted.

In 2006, policy loans were recorded at cost and were fully secured by the cash surrender value of the insurance policies on which the loans were granted.

> **Other investments**

In 2007, pursuant to the adoption of the new standard on financial instruments, other investments are recorded at their fair value. In 2006, they were carried at cost.

> **Goodwill**

Goodwill represents the excess of the cost of businesses acquired over the fair value of the net identifiable assets. Goodwill is tested for impairment annually or more often if events or changes in circumstances indicate that it might be impaired. When the carrying amount of goodwill exceeds its fair value, an impairment loss is charged to income.

> **Intangible assets**

Intangible assets consist of indefinite-life intangible assets and finite-life intangible assets. Indefinite-life intangible assets are not amortized but are assessed for impairment annually. When the carrying amounts of the indefinite-life intangible assets exceed their estimated fair value, an impairment loss is charged to income.

Finite-life intangible assets are amortized on a straight-line basis over ten- and twelve-year periods.

> **Other assets**

Other assets consist of property, plant and equipment, deferred charges, future income taxes, income taxes receivable, retained interests, prepaid expenses, lease acquisition expenses, investment income receivable and other receivables.

Retained interests, investment income receivable and other receivables are classified as loans and receivables and are reported at amortized cost.

Property, plant and equipment, consisting primarily of furniture, computer hardware and software, leasehold improvements and rolling stock, are reported at amortized cost. Amortization is calculated using the straight-line and declining balance methods over expected useful life at rates ranging from 10% to 33%.

Deferred charges consist primarily of commissions, taxes on premiums and mortgage loan acquisition expenses. They are reported at amortized cost and amortization is calculated using the straight-line method over a period not exceeding five years.

Lease acquisition expenses are reported at amortized cost and amortized over the terms of the leases.

3) Accounting policies [Cont'd]

> Impairment of long-lived assets

Where significant circumstances or events indicate a possible impairment, the Mutual revalues the carrying value of long-lived assets. Impairment exists when the carrying amount of an asset exceeds the sum of the expected future undiscounted cash flows from that asset. The amount of impairment loss representing the excess of net carrying value over fair value is recognized in income for the year.

> Segregated fund policies

The segregated fund consists of the assets of the pension plans of La Capitale group. These assets are fully administered by a subsidiary of the Mutual, but are excluded from the assets of the general fund. The assets of the segregated fund are recorded at fair value.

> Actuarial liabilities

Actuarial liabilities represent the amount that, when added to premiums and future investment income, secures current policy commitments. These actuarial liabilities are determined using the Canadian asset liability method, which is in accordance with the practice established by the Canadian Institute of Actuaries.

> Provision for claims and loss adjustment expenses

Claims and loss adjustment expenses are charged to income as incurred. The provision for claims and loss adjustment expenses is initially determined on a case-by-case basis for each claim reported and includes an additional amount based on the estimate of claims incurred but not reported. The provision is recorded on a discounted basis.

Determining the provision for claims and loss adjustment expenses and the related reinsurers' share requires the estimation of three major variables: changes in claims, collections related to reinsurance and future investment income. It also includes a provision for adverse deviation, as required by Canadian accepted actuarial practice.

The provision for claims and loss adjustment expenses and the related reinsurers' share are estimates subject to variability during the year. These variations are due to events affecting the ultimate settlement of claims, but which have not yet occurred and may not occur for some time. These variations may also be caused by additional information regarding the claims, by changes in court interpretations of policies, or by significant differences in claim severity and frequency relative to historical trends. The estimates are based on the experience of the Mutual's subsidiaries. According to management, the estimation methods used produce reasonable results based on the data currently available.

> Income taxes

Income tax is carried according to the liability method. Using this method, future income tax assets and liabilities are recognized for all temporary differences between the carrying amount in the financial statements and the corresponding fiscal values. These future income tax assets and liabilities are calculated at tax rates expected to apply when the assets are realized or the liabilities settled.

> Derivative financial instruments

A subsidiary of the Mutual uses derivative financial instruments to hedge against interest rate fluctuations. In connection with asset-liability matching, said subsidiary uses interest rate (reverse) repurchase agreements.

To hedge against interest rate risk related to mortgage loans that are or are being securitized, the subsidiary also uses interest rate (reverse) repurchase agreements. Any gains or losses realized on these derivatives offset the losses or gains recognized on the pool of securitized mortgage loans as a result of changes in interest rates.

In order to benefit from a lower capital cost during securitizations, the subsidiary uses interest rate swaps.

Another subsidiary of the Mutual uses derivative financial instruments in the management of its exchange rate risks.

In 2007, pursuant to the adoption of the new standard on financial instruments, such derivatives are recognized at their fair value and subsequent changes, as well as realized gains and losses, are recognized in net income for the year.

In 2006, interest rate swaps were recognized at their fair value and exchange rate contracts were carried off-balance sheet.

Gains and losses resulting from interest rate (reverse) repurchase agreements used to match assets and liabilities were deferred and amortized mainly over two-year periods.

Realized gains and losses on interest rate (reverse) repurchase agreements used to hedge against the interest rate risk related to mortgage loans that are or are being securitized were amortized over the average term of the securitized mortgage loans.

> **Pension plans and employee future benefits**

The Mutual offers defined benefit pension plans and post-employment benefits to its employees and directors. It accounts for its obligations under these plans after deducting the assets of the plans. The cost of pension and post-employment benefits obtained by employees is calculated actuarially according to the projected benefit method prorated to the number of years of service and management's best estimates regarding the projected return on investments, salary escalation, the retirement age of employees and projected health care costs. Plan obligations are discounted based on current market interest rates, and plan assets are recorded at fair value.

The excess of the net actuarial gain or loss over 10% of the greater of the benefit obligation, the fair value of plan assets and the transitional (asset) obligation is amortized over the average remaining service life of employees.

> **Share appreciation rights plan**

The expense in respect of the stock appreciation rights plan is charged to income for the year when the return on shares is earned under the plan.

> **Foreign currency translation**

Foreign currency accounts are translated according to the temporal method. Under this method, balance sheet monetary items are translated at the rates in effect at year-end, while non-monetary items are translated at historical exchange rates. Revenues and expenses are translated using rates in effect on the transaction date or average exchange rates for the period. Translation gains and losses are included in income for the year.

4) Future accounting policy changes

> **Capital disclosure and disclosure and presentation of financial instruments**

On December 1, 2006, the Canadian Institute of Chartered Accountants (CICA) issued three new accounting standards: Section 1535, Capital Disclosures, Section 3862, Financial Instruments – Disclosures and Section 3863, Financial Instruments – Presentation. The Company is currently assessing the impact of these standards on disclosure in view of their future implementation.

Section 1535 identifies disclosure requirements regarding:

– capital management objectives, policies and processes
– certain quantitative data on the components of capital management
– compliance with regulatory capital requirements and the consequences of non-compliance with said requirements

Sections 3862 and 3863 describe the disclosure and presentation requirements for financial instruments, replacing Section 3861 Financial Instruments – Disclosure and Presentation. These new standards require the disclosure of additional information on the nature and extent of risks arising out of financial instruments to which the Company is exposed and on the management of these risks.

> **International Financial Reporting Standards**

In January 2006, Canada's Accounting Standards Board (AcSB) unveiled a strategic plan which proposes that public companies, including insurance companies, should move toward a single set of globally accepted high-level standards, namely the International Financial Reporting Standards (IFRS). Under the AcSB plan, still subject to change, this new set of standards will be applied for years beginning on or after January 1, 2011.

5) Investments

> Classification of securities

	2007				
	Held-for-trading	Designated as held-for-trading	Available-for-sale	Loans and receivables	Total
Bonds	$—	$892,058	$318,094	$—	$1,210,152
Mortgage loans	—	—	—	479,522	479,522
Stocks	—	118,310	232,172	—	350,482
Cash and short-term deposits	100,405	—	—	—	100,405
Policy loans	—	—	—	23,349	23,349
Other investments	—	—	—	20,142	20,142
	$100,405	$1,010,368	$550,266	$523,013	$2,184,052

> Credit and concentration risk

Credit risk is the risk of financial loss to which the Mutual and its subsidiaries can be exposed if certain of their borrowers fail to make capital or interest payments when due. Concentration risk arises when investments are made with one or more entities having similar characteristics.

The following tables provide data on the credit and concentration risk of the Mutual and its subsidiaries.

Bonds

	2007			2006		
	Carrying value	Fair value	Rate of return[(1)]	Carrying value	Fair value	Rate of return[(1)]
Securities issued or collateralized by:						
Canada	$112,354	$112,354	4.38%	$80,037	$80,562	4.07%
Provinces	995,623	995,623	6.54	773,505	960,154	6.66
Municipalities, school boards and hospitals	28,727	28,727	9.54	35,245	40,734	8.95
Other	73,448	73,448	5.22	106,513	102,986	5.30
	$1,210,152	$1,210,152	6.33%	$995,300	$1,184,436	6.39%

(1) Rate of return based on amortized cost.

The life and health insurance companies limit their corporate bond investments to 40% of their bond portfolio with a maximum 2% per issuer.

The property and casualty insurance companies place a maximum limit of 10% of shareholders' equity on investment in one or more entities of a related group.

Subsidiaries of the Mutual hold investments in the form of non-bank sponsored asset-backed commercial paper covered by the Montréal Accord for an amount of $1,098 as at December 31, 2007. A loss of $210 ($65, net of income taxes) was recorded in recognition of the permanent and significant impairment of these investments. These securities have not been traded in an active market since mid-August 2007. The method used to estimate these provisions is based on a review of the quality of the underlying financial assets grouped in broad categories, each of which has been assigned depreciation probabilities according to information available as at December 31, 2007.

Mortgage loans

	2007		2006	
	Carrying value	**Fair value**	Carrying value	Fair value
Insured	**$293,891**	**$286,309**	$240,484	$238,039
Conventional	**185,631**	**183,697**	168,993	169,657
	$479,522	**$470,006**	$409,477	$407,696

A subsidiary of the Mutual limits its investment to $400 for a new borrower and $800 for a related group of borrowers for new loans.

As at December 31, 2007, a mortgage loan amounting to $13,471 [$7,512 in 2006] was receivable from the joint venture.

Stocks

	2007		2006	
	Carrying value	**Fair value**	Carrying value	Fair value
Common shares and participating units	**$184,366**	**$184,366**	$138,953	$181,755
Preferred shares	**56,480**	**56,480**	35,775	38,330
Participating units in trading indices	**109,636**	**109,636**	81,573	81,573
	$350,482	**$350,482**	$256,301	$301,658

The life and health insurance companies limit their investment in a company or group of related companies to 1/2 of 1% of the combined assets of La Capitale Civil Service Insurer Inc. and La Capitale Insurance and Financial Services Inc.

The property and casualty insurance companies place a maximum limit of 10% of shareholders' equity on investment in one or more entities of a related group.

Real estate

	2007		2006	
	Carrying value	**Fair value**	Carrying value	Fair value
Held for investment	**$124,334**	**$154,421**	$118,713	$145,886
Held for resale	**2,474**	**2,474**	2,245	2,245
	$126,808	**$156,895**	$120,958	$148,131

Real estate is reported net of $3,090 in accumulated amortization ($2,622 in 2006) of which $568 is attributable to fiscal 2007 [$359 in 2006].

Cash and short-term deposits and policy loans

	2007		2006	
	Carrying value	**Fair value**	Carrying value	Fair value
Cash and short-term deposits	**$100,405**	**$100,405**	$74,222	$74,222
Policy loans	**$23,349**	**$23,349**	$21,864	$21,864

5) Investments [Cont'd]

> **Credit and concentration risk [Cont'd]**

Other investments

	2007		2006	
	Carrying value	**Fair value**	Carrying value	Fair value
Personal loans	**$16,868**	**$16,644**	$19,618	$19,439
Other loans	**2,156**	**2,156**	1,354	1,354
Other investments	**1,118**	**1,118**	4,472	4,551
	$20,142	**$19,918**	$25,444	$25,344

Personal loans include share purchase loans of a subsidiary in favour of employees amounting to $9,551 [$11,852 in 2006]. The interest rate of these loans is the Government of Canada's prescribed rate. The loans are collateralized by a movable hypothec with delivery of shares of the subsidiary. In addition, the employee agrees to provide the subsidiary, upon request, any additional hypothec that the latter deems necessary to maintain the value of the collateral.

> **Interest rate risk**

Interest rate risk is the risk of loss attributable to interest rate fluctuations.

The following tables summarize the maturity dates and fair values of the invested assets that are subject to interest rate risk.

Bonds

	2007		2006	
	Carrying value	**Fair value**	Carrying value	Fair value
Maturity in less than one year	**$39,864**	**$39,864**	$73,511	$72,554
Maturity between one and five years	**204,996**	**204,996**	206,270	216,803
Maturity between five and ten years	**230,760**	**230,760**	212,681	241,717
Maturity in more than ten years	**734,532**	**734,532**	502,838	653,362
	$1,210,152	**$1,210,152**	$995,300	$1,184,436

Mortgage loans

	2007		2006	
	Carrying value	**Fair value**	Carrying value	Fair value
Maturity in less than one year	**$107,970**	**$108,317**	$99,098	$99,298
Maturity between one and five years	**321,081**	**315,318**	273,457	270,640
Maturity between five and ten years	**45,741**	**41,998**	32,084	32,937
Maturity in more than ten years	**4,730**	**4,373**	4,838	4,821
	$479,522	**$470,006**	$409,477	$407,696

The effective interest rate for bonds, based on amortized cost, ranged from 3.34% to 12.65% [from 2.72% to 12.65% in 2006] and, for mortgage loans, ranged from 3.85% to 11.50% [from 1.40% to 11.50% in 2006].

Mortgage loans

	2007			2006		
	Carrying value	**Average interest rate**	**Average loan maturity (years)**	Carying value	Average interest rate	Average loan maturity (years)
Residential	**$423,058**	**5.53%**	**2.88**	$368,884	5.36%	3.09
Other	**56,464**	**5.62**	**5.73**	40,593	6.57	4.81
	$479,522	**5.54%**	**3.22**	$409,477	5.48%	3.26

6) Impaired loans

The following tables summarize impaired loans and the related allowance for impaired loans.

i) Impaired loans

	2007			2006		
	Gross loans	**Allowance for impaired loans**	**Carrying value**	Gross loans	Allowance for impaired loans	Carrying value
Mortgage loans	**$795**	**$49**	**$746**	$841	$54	$787
Personal loans	**119**	**119**	**—**	91	91	—
	$914	**$168**	**$746**	$932	$145	$787

ii) Allowance for impaired loans

The changes made during the year to the allowance for impaired loans are as follows:

	2007	2006
Allowance, beginning of year	**$145**	$188
Loan impairment charges	**78**	102
Write-offs	**(7)**	(128)
Recoveries	**(48)**	(17)
Allowance, end of year	**$168**	$145

7) Goodwill

	2007	2006
Balance, beginning of year	$57,919	$8,296
Adjustment to purchase cost of AGA Financial Group Inc.	105	6
Purchase of 3602214 Canada Inc. *[note 22]*	—	49,617
Adjustment after final allocation of purchase price of 3602214 Canada Inc. *[note 22]*	(4,364)	—
Purchase of La Capitale Participations inc. [5%] *[note 22]*	6,129	—
Purchase of La Capitale Financial Group Inc. [0.9%] *[note 22]*	2,223	—
	$62,012	$57,919

8) Intangible assets

	2007					
	Cost, beginning of year	Ajustment after final allocation of purchase price *[note 22]*	Acquisition	Cost end of year	Accumulated amortization	Net carrying value
Indefinite life						
Trademarks	$2,679	$(1,340)	$—	$1,339	$—	$1,339
Finite life						
Clients and distribution networks	34,513	—	171	34,684	9,189	25,495
Total	$37,192	$(1,340)	$171	$36,023	$9,189	$26,834

	2006				
	Cost, beginning of year	Acquisition	Cost end of year	Accumulated amortization	Net carrying value
Indefinite life					
Trademarks	$—	$2,679	$2,679	$—	$2,679
Finite life					
Clients and distribution networks	29,909	4,604	34,513	5,873	28,640
Total	$29,909	$7,283	$37,192	$5,873	$31,319

During the year, the Mutual recorded amortization charges totalling $3,316 [$2,994 in 2006] through income.

9) Other assets

Other assets consist of the following:

	2007	2006
Property, plant and equipment	$74,537	$65,472
Accumulated amortization	(53,136)	(50,489)
	$21,401	$14,983
Deferred charges	24,450	21,563
Future income taxes *[note 19]*	9,967	22,235
Income taxes receivable	23,189	7,758
Retained interests	13,526	16,063
Prepaid expenses	11,202	9,372
Lease acquisition expenses	6,822	7,329
Investment income receivable	11,355	10,201
Other receivables	36,711	42,466
	$158,623	$151,970

Amortization for the year was $10,065 [$14,560 in 2006].

The fair value of investment income receivable and other receivables approximates their carrying value due to their short-term maturities.

10) Securitization

During the year, a subsidiary of the Mutual securitized residential mortgage loans totalling $162,455 [$214,639 in 2006] for net cash proceeds of $161,422 [$212,741 in 2006] and retained the rights to the excess spread on mortgage loans amounting to $5,170 [$7,998 in 2006]. A net loss of $1,365 [net gain of $724 in 2006] was reported in net investment income.

The key assumptions used to determine the value of the loans sold and retained interests at the securitization date are as follows:

> **Key assumptions**

	2007	2006
Prepayment rate	5.00%	2.91%
Excess spread	0.87%	1.17%
Discount rate	4.50%	4.44%

10) Securitization [Cont'd]

As of December 31, 2007, the sensitivity of the current fair value of retained interests to 10% and 20% adverse changes in the key assumptions was as follows:

> **Sensitivity of key assumptions to adverse changes**

	2007		2006	
	Assumption	**Impact on fair value**	Assumption	Impact on fair value
Prepayment rate				
Impact on fair value of 10% adverse change	**5.50**%	$(**59**)	3.20%	$(70)
Impact on fair value of 20% adverse change	**6.00**%	$(**117**)	3.49%	$(98)
Excess spread (net of credit losses)				
Impact on fair value of 10% adverse change	**0.79**%	$(**532**)	1.06%	$(1,005)
Impact on fair value of 20% adverse change	**0.70**%	$(**1,048**)	0.94%	$(1,962)
Discount rate				
Impact on fair value of 10% adverse change	**4.95**%	$(**50**)	4.88%	$(127)
Impact on fair value of 20% adverse change	**5.40**%	$(**100**)	5.33%	$(203)

These sensitivities are hypothetical and should be used with caution. As shown by the tabular figures, the effect on fair value of a 10% adverse change generally cannot be extrapolated because the relationship between the change in assumption and the change in fair value may not be linear. Also, in this table, the impact of a variation in a particular assumption on the fair value of retained interests is calculated without changing any other assumption; generally, changes in any given factor could produce changes in another, thus magnifying or counteracting sensitivity.

The following table summarizes certain cash flows from securitization trusts:

Cash flows from securitization trusts

Residential mortgage loans	**2007**	2006
Proceeds from new securitization transactions	$**161,422**	$212,741
Cash flows from retained interests insecuritization transactions	$**3,239**	$4,210

Securitized loans totalled $574,163 [$574,685 in 2006].

11) Credit facilities

The Mutual and its subsidiaries have lines of credit of $15,225 [$15,225 in 2006] bearing interest at prime. A subsidiary has a $40,000 demand bridge loan bearing interest at the bankers' acceptance rate [4.67%] plus 50 basis points or at prime [6.00%], based on its use. The loan is collateralized by bond holdings whose fair value must cover 105% of the amount drawn. An amount of $15,000 [nil in 2006] was drawn on the credit facilities as at December 31, 2007.

12) Policy liabilities

The Board of Directors names the Appointed Actuary, who is responsible for valuing policy liabilities in accordance with the standards of practice of the Canadian Institute of Actuaries and for expressing an opinion regarding their adequacy to meet all policyholder obligations of the companies at the balance sheet date. In addition, the Appointed Actuary is required each year to prepare a report for the Board of Directors on the capital adequacy of these companies over the next five years.

As at December 31, policy liabilities and the assets backing such liabilities are summarized as follows:

	2007			2006		
Policy liabilities	**Participating**	**Non-participating**	**Total**	Participating	Non-participating	Total
Individual						
Life	$573,971	$124,404	$698,375	$381,344	$97,756	$479,100
Annuities	2,350	584,309	586,659	2,504	499,550	502,054
Health	—	191,990	191,990	—	167,067	167,067
Group						
Life	—	45,081	45,081	—	37,277	37,277
Annuities	—	1,966	1,966	—	1,884	1,884
Health	—	148,036	148,036	—	122,122	122,122
	$576,321	$1,095,786	$1,672,107	$383,848	$925,656	$1,309,504

	2007						
Assets backing policy liabilities	**Individual**			**Group**			
	Life	**Annuities**	**Health**	**Life**	**Annuities**	**Health**	**Total**
Participating							
Bonds	$442,112	$1,809	$—	$—	$—	$—	$443,921
Mortgage loans	12,840	53	—	—	—	—	12,893
Real estate	83,611	342	—	—	—	—	83,953
Stocks	8,308	34	—	—	—	—	8,342
Other	27,100	112	—	—	—	—	27,212
	$573,971	$2,350	$—	$—	$—	$—	$576,321
Non-participating							
Bonds	$115,867	$40,725	$190,807	$27,409	$661	$64,787	$440,256
Mortgage loans	—	425,121	27	8,659	493	44,772	479,072
Real estate	2,826	1,570	128	—	—	—	4,524
Stocks	713	109,222	32	—	—	—	109,967
Other	4,998	7,671	996	9,013	812	38,477	61,967
	$124,404	$584,309	$191,990	$45,081	$1,966	$148,036	$1,095,786
Total	$698,375	$586,659	$191,990	$45,081	$1,966	$148,036	$1,672,107

12) Policy liabilities [Cont'd]

Assets backing policy liabilities	2006						
	Individual			Group			
	Life	Annuities	Health	Life	Annuities	Health	Total
Participating							
Bonds	$277,852	$2,094	$—	$—	$—	$—	$279,946
Mortgage loans	14,653	96	—	—	—	—	14,749
Real estate	77,658	510	—	—	—	—	78,168
Stocks	6,476	42	—	—	—	—	6,518
Other	4,705	(238)	—	—	—	—	4,467
	$381,344	$2,504	$—	$—	$—	$—	$383,848
Non-participating							
Bonds	$76,690	$43,956	$163,512	$26,765	$933	$61,731	$373,587
Mortgage loans	—	345,120	8	9,433	553	42,847	397,961
Real estate	—	986	—	—	—	34	1,020
Stocks	554	80,530	31	—	—	—	81,115
Other	20,512	28,958	3,516	1,079	398	17,510	71,973
	$97,756	$499,550	$167,067	$37,277	$1,884	$122,122	$925,656
Total	$479,100	$502,054	$167,067	$37,277	$1,884	$122,122	$1,309,504

The fair value of policy liabilities was $1,684,000 ($1,526,000 in 2006) and was based on the fair value of assets backing such liabilities given the interrelationship between these two balance sheet items.

> ASSUMPTIONS

In computing policy liabilities, the assumptions were determined using the Appointed Actuary's best estimates as to policy terms regarding numerous variables, such as mortality, morbidity, investment return, policy management expenses, future income taxes, policy lapses and participating policyholder dividends. Margins for adverse deviations are then factored into these best estimates by the actuary to determine final assumptions used.

The following methods were used to determine the most significant assumptions:

Mortality

For individual life insurance mortality, the assumption stems from a combination of the most recent experience of the companies and the industry published by the Canadian Institute of Actuaries. For group life insurance mortality, the assumption is based on recent industry experience.

For annuity mortality, the assumption is derived from the most recent industry experience published by the Canadian Institute of Actuaries. Moreover, the assumption used incorporates an improvement with regard to the current mortality level.

Morbidity

The assumption is based on industry morbidity tables, which are modified to reflect the recent experience of the companies.

Investment return

The life and health insurance companies hold assets backing the policy liabilities. The expected rates of return for these assets are estimated based on current economic prospects, the investment policy of the companies and anticipated cash flows by business line.

No assets backing policy liabilities are classified as available-for-sale, which matches investment income to changes in actuarial liabilities for accounting purposes, both of which are recognized in the statement of income. As for policy liabilities other than actuarial liabilities, the accounting mismatch is low.

To reflect interest rate risk, that is, the financial loss that may arise from fluctuations in interest rates, the companies match each group of assets to the liabilities they back. This matching, which consists in managing spreads in maturities between assets and liabilities as well as expected net cash flows, minimizes potential losses related to interest rate risk.

The companies manage credit risk through detailed credit and underwriting policies, and by placing aggregate limits on each issuer in their investment portfolios. An allowance for impaired loans was established and was charged against the value of these loans. Moreover, actuarial liabilities include an amount to cover any potential payment defaults in respect of assets currently held by the companies. The potential payment defaults are factored in by reducing the expected rate of return of the asset. The reduction in rate of return is based on the risk of payment default for each asset class.

Policy management expenses

Policy management expenses are determined using internal cost allocation studies of the life and health insurance companies, based on the actual or budgeted overhead costs for the following fiscal year. These expenses are indexed to inflation for the coming years and take into account the anticipated business growth of the life and health insurance companies as well as economic conditions.

Future income taxes

Actuarial liabilities include amounts reflecting the interest-producing nature of the assets backing the future income tax liabilities recorded in the balance sheet. As at December 31, 2007, actuarial liabilities were reduced by $10,435 [$5,797 in 2006] in relation to this item and are established only for future income taxes related to policy liabilities.

Policy lapses

Assumptions regarding policy lapses are based on a study of the recent experience of the life and health insurance companies for each business line.

Participating policyholder dividends

Actuarial liabilities include amounts relating to regular future dividends to be paid to policyholders. The dividend scales are in keeping with policyholders' reasonable expectations and the assumptions used in measuring actuarial liabilities.

Margins for adverse deviations

The basic assumptions used to determine policy liabilities are the best estimates as to a range of possible results. Each assumption must include an additional margin for adverse deviations in order to recognize the uncertainty regarding the preparation of best estimates and to take into account potential policy liability deterioration. These margins provide better assurance that policy liabilities will be sufficient to cover future policy benefit payments.

12) Policy liabilities [Cont'd]

> CHANGES IN ACTUARIAL LIABILITIES

	2007	2006
Previously reported opening balance	$1,245,917	$953,023
Effect of new accounting standards *[note 2]*	235,215	—
Adjusted opening balance	$1,481,132	$953,023
Adjustment after final allocation of purchase price *[note 22]*	(5,360)	—
Business acquisition *[note 22]*	—	212,956
Balance before the following items	$1,475,772	$1,165,979
Normal changes	$128,488	$94,882
Changes related to assumptions		
Interest	$155	$(17,245)
Other	(4,299)	4,551
	$(4,144)	$(12,694)
Miscellaneous changes	$1,208	$(2,250)
	$125,552	$79,938
Closing balance	$1,601,324	$1,245,917

> REINSURANCE

To reduce the risk related to insurance benefits, the life and health insurance companies have entered into reinsurance agreements for policies whose insured principal exceeds certain maximums as well as reinsurance agreements for the sharing of certain risks with reinsurers on a pro rata basis. Reinsurance is purchased primarily from registered life and health insurance companies. In addition, the life and health insurance companies share individual and group insurance risks among themselves. Reinsurance does not discharge the ceding company of its policy liabilities. The effect of the various reinsurance agreements in respect of actuarial liabilities and claims receivable is summarized as follows:

	Decrease in actuarial liabilities		Amounts of claims receivable	
	2007	2006	2007	2006
Individual				
Life	$36,768	$30,708	$371	$379
Health	10,868	8,149	—	—
Group				
Life	2,225	2,531	25	151
Health	54,757	50,537	3,109	2,868
	$104,618	$91,925	$3,505	$3,398

Failure of reinsurers to honour their obligations could result in losses to these companies. Said companies have adopted a review process to verify the solvency of the companies to which they cede. The companies have no knowledge of any information leading them to believe that a reinsurer with which they currently do business is insolvent; consequently, no provision for bad debts has been recorded. In addition, the companies deal with several reinsurers.

13) Provision for claims and loss adjustment expenses

a) The following table summarizes the items related to the provision for claims and loss adjustment expenses:

	2007	2006
Gross provision	$80,556	$74,809
Salvage and subrogation receivable	8,590	8,683
Reinsurers' share	3,382	4,402
Net provision	$68,584	$61,724

b) Reinsurance ceded

In the normal course of business, property and casualty insurance companies seek to reduce the loss that may arise from catastrophes or other events that give rise to unfavourable underwriting results by reinsuring certain levels of risk with other insurers. Information regarding reinsurer solvency is provided in note 12.

14) Long-term debt

	2007	2006
Loans collateralized by immovable hypothecs, 6.51%	$—	$6,428
Other loans	210	14
Current portion	(82)	—
	$128	$6,442

The interest on long-term debt amounted to $137 [$421 in 2006].

The fair value of long-term debt stood at $195 [$6,467 in 2006] and was estimated using a discounted cash flow calculation that uses market interest rates currently charged for similar debt.

Payments on long-term debt over the next three fiscal years amount to $82 in 2008, $78 in 2009 and $50 in 2010.

15) ACCRUED AND OTHER LIABILITIES

Other liabilities consist of the following:

	2007	2006
Future income taxes *[note 19]*	$53,517	$42,960
Income taxes payable	1,674	4,081
Deposits for taxes	6,202	5,772
Other	2,881	2,553
	$64,274	$55,366

The fair value of accrued and other financial liabilities included in other liabilities approximate their carrying value due to their short-term maturities.

16) Retained earnings

Retained earnings consist of the following items:

	2007	2006
Equity capital	$329,030	$265,578
Participating policyholders' surplus	101,719	84,643
	$430,749	$350,221

17) Share appreciation rights plan

Certain subsidiaries of the Mutual offer a share appreciation rights plan to their executives. Under this plan, participants are entitled to receive cash compensation based on appreciation in a subsidiary's share value in excess of the initial value determined under the plan. The rights must be exercised when participants leave the position that entitles them to the plan. The accumulated amounts are payable under terms that vary according to the participant's departure type (transfer, retirement, permanent disability, death and voluntary termination) over a maximum term of four years following the date of the termination.

Plan expense for the year amounted to $3,097 [$941 in 2006].

18) INTEREST IN A JOINT VENTURE

A subsidiary of the Mutual holds 50% of Société Bon Pasteur (s.e.n.c.). The latter manages two buildings held for the rental of office and commercial space as well as the rental of residential space.

This subsidiary exercises joint control over this company. The Mutual's share of assets and liabilities and of items in the statements of income and cash flows are summarized as follows:

	2007	2006
BALANCE SHEET		
Assets	$19,274	$19,442
Liabilities	13,680	14,090
Net assets of the joint venture	$5,594	$5,352
STATEMENT OF INCOME		
Revenues	$3,522	$3,413
Expenses	3,124	2,983
Net income	$398	$430
STATEMENT OF CASH FLOWS		
Cash flows related to operating activities	$712	$514
Cash flows related to investing activities	$—	$(51)
Cash flows related to financing activities	$(625)	$(425)

19) Net investment income

	2007					
	Held-for-trading	**Designated as held-for-trading**	**Available-for-sale**	**Loans and receivables**	**Other**	**Total**
Bonds						
Interest	$—	$47,049	$11,841	$—	$—	$58,890
Realized gains	—	—	2,787	—	—	2,787
Change in fair value	—	(11,995)	—	—	—	(11,995)
Mortgage loans	—	—	—	26,201	—	26,201
Stocks						
Dividends	—	2,524	7,120	—	—	9,644
Realized gains	—	—	16,654	—	—	16,654
Change in fair value	—	4,760	—	—	—	4,760
Real estate	—	—	—	—	9,593	9,593
Policy loans	—	—	—	1,560	—	1,560
Other	781	1,708	990	3,572	1,645	8,696
	$781	$44,046	$39,392	$31,333	$11,238	$126,790
Investment expenses	1	734	854	9,056	173	10,818
	$780	$43,312	$38,538	$22,277	$11,065	$115,972

	2006
Interest, dividends, net rental income and other gains	$90,599
Amortization of deferred net gains on bonds	6,710
Amortization of deferred and unrealized net gains on real estate and stocks	18,147
Net gains (losses) on impaired loans and mortgage foreclosures	(96)
	$115,360

20) Income taxes

The actual provision for income taxes differs from the provision that would have been established using the combined statutory federal and provincial rate for the following reasons:

	2007	2006
Provision for income taxes based on the combined statutory federal and provincial rate	**$36,390**	$26,116
Change in income taxes resulting from the following:		
Non-taxable items	**(2,109)**	(1,302)
Future income taxes arising from a change in tax rate	**(4,494)**	(1,815)
Other	**(559)**	(632)
	$29,228	$22,367
Income taxes on investment income	**$1,435**	$1,270
Other income taxes	**—**	34
	$1,435	$1,304
	$30,663	$23,671

Income tax expense is broken down as follows:

	2007	2006
Current	**$14,832**	$19,892
Future	**15,831**	3,779
	$30,663	$23,671

The tax consequences of the temporary differences that generate future income tax assets or liabilities are as follows:

	2007	2006
Future income tax assets		
Stocks	**$43**	$7,149
Accrued liabilities	**6,113**	5,078
Tax losses	**5,901**	6,295
Other	**4,040**	9,843
	$16,097	$28,365
Valuation allowance	**(6,130)**	(6,130)
	$9,967	$22,235
Future income tax liabilities		
Advances	**$6,300**	$6,731
Bonds	**58,035**	12,012
Real estate	**10,753**	11,141
Actuarial liabilities	**(49,381)**	6,384
Intangible assets	**6,616**	8,583
Deferred net tax gains	**22,177**	1,875
Other	**(983)**	(3,766)
	$53,517	$42,960

21) Cash and cash equivalents

Cash and cash equivalents consist of cash and short-term deposits less the excess of outstanding cheques over cash. Cash and cash equivalents in the statement of cash flows include the following balance sheet amounts:

	2007	2006
Cash and short-term deposits [less than three months]	$100,116	$73,938
Excess of outstanding cheques over cash	(1,487)	(5,934)
	$98,629	$68,004

22) Business acquisitions

On November 30, 2006, a subsidiary of the Mutual acquired 70% of the common shares of 3602214 Canada Inc. This company and its wholly owned subsidiary, Penncorp Life Insurance Company, operate in the life and health insurance industry in Canada. They provide individual life, accident and health insurance products to their clients.

The consolidated financial statements include the results of these companies since their acquisition.

This acquisition was recorded using the purchase method and the final purchase price allocation is as follows, based on the fair value of net assets acquired:

	2007
ASSETS ACQUIRED	
Bonds	$277,575
Liquid assets	7,207
Future income tax assets	956
Goodwill	45,253
Intangible assets	5,722
Other assets	6,313
	$343,026
LIABILITIES ASSUMED	
Policy liabilities	$207,596
Accrued liabilities	4,471
Deferred revenues	7,578
Non-controlling interests	20,184
	$239,829
NET ASSETS ACQUIRED	$103,197

During 2007, a subsidiary of the Mutual acquired 5% of the Class G and Class Y shares of La Capitale Participations inc. for an amount of $13,629. This acquisition was recorded using the purchase method, and the fair value of net identifiable assets and goodwill are $7,500 and $6,129, respectively.

During 2007, the Mutual also acquired 0.9% of the Class B, C, E, Y and Z shares of La Capitale Financial Group Inc. for an amount of $6,493. This acquisition was recorded using the purchase method, and the fair value of net identifiable assets and goodwill are $4,270 and $2,223, respectively.

23) Pension plans and employee future benefits

The Mutual and its subsidiaries have four defined benefit plans that guarantee payment pension benefits to most employees. These plans are based on years of service and use final average earnings or annually indexed pension credits. Pension benefits are increased based on the consumer price index up to a maximum of 3% each year. These plans are funded. Furthermore, the Mutual has additional unfunded plans for certain employees.

Other employee benefits include retirees' contributory health insurance plans for which employee contributions are adjusted annually, life insurance plans and retirement celebration costs. These plans are not funded.

Information related to the pension plans and other employee benefits is as follows:

	Pension plans		Other employee benefits	
	2007	2006	**2007**	2006
Accrued benefit obligation				
Balance, beginning of year	**$211,642**	$181,655	**$7,107**	$4,390
Past service costs	**—**	—	**1,718**	—
Employee contributions	**5,123**	4,614	**—**	—
Current service costs	**9,309**	8,051	**786**	340
Transfers	**333**	457	**—**	—
Interest	**10,805**	9,597	**332**	239
Actuarial losses (gains)	**(24,616)**	16,230	**(818)**	2,216
Benefits paid	**(4,028)**	(8,962)	**(97)**	(78)
Balance, end of year	**$208,568**	$211,642	**$9,028**	$7,107

The accrued benefit obligation is allocated as follows:

	Pension plans		Other employee benefits	
	2007	2006	**2007**	2006
Funded plans	**$197,789**	$200,996	**$—**	$—
Unfunded plans	**10,779**	10,646	**9,028**	7,107
	$208,568	$211,642	**$9,028**	$7,107
Net assets				
Fair value, beginning of year	**$184,882**	$155,785	**$—**	$—
Actual return on plan assets	**4,094**	15,696	**—**	—
Employer contributions	**7,984**	12,191	**—**	—
Employee contributions	**4,744**	4,369	**—**	—
Transfers	**333**	457	**—**	—
Benefits paid	**(4,028)**	(3,616)	**—**	—
Fair value, end of year	**$198,009**	$184,882	**$—**	$—

	Pension plans		Other employee benefits	
	2007	2006	**2007**	2006
Funded status – net deficit	$(**10,559**)	$(26,760)	$(**9,028**)	$(7,107)
Unamortized net actuarial loss	**13,876**	32,175	**1,736**	2,597
Unamortized past service costs	—	—	**1,234**	—
Unamortized transitional obligation (asset)	(**5,088**)	(5,590)	**819**	918
Accrued benefit liability	$(**1,771**)	$(175)	$(**5,239**)	$(3,592)
Provision for employee share	(**36**)	(456)	—	—
Accrued benefit liability, including provision for employee share	$(**1,807**)	$(631)	$(**5,239**)	$(3,592)

Pension plan assets were measured as at December 31, 2007 and accrued benefit obligations were measured as at December 31, 2006 and projected to December 31, 2007.

Pension plan assets do not include securities of the Mutual and its subsidiaries.

The breakdown of assets at fair value by main asset class is as follows:

	Pension plans		Other employee benefits	
	2007	2006	**2007**	2006
Asset class				
Stocks	**61**%	59%	—%	—%
Bonds	**38**	40	—	—
Other	**1**	1	—	—
Total	**100**%	100%	—%	—%

The following table summarizes the weighted average actuarial assumptions used to calculate the accrued benefit obligation and expenses:

	Pension plans		Other employee benefits	
	2007	2006	**2007**	2006
To determine the accrued benefit obligation				
Discount rate	**5.55**%	4.95%	**5.55**%	4.95%
Rate of increase in future compensation	**4.10**%	4.10%	—%	—%
To determine benefit expenses				
Discount rate	**4.95**%	5.10%	**4.9**%	5.10%
Expected rate of return on plan assets	**6.00**%	6.00%	—%	—%
Rate of increase in future compensation	**4.10**%	4.10%	—%	—%
Health care cost trend rates for retirees				
Under age 65	—%	—%	**5.00**%	5.00%
Age 65 and over	—%	—%	**4.50**%	4.50%

23) Pension plans and employee future benefits [Cont'd]

The net expenses in respect of employee pension plans and other employee benefits are as follows:

	Pension plans		Other employee benefits	
	2007	2006	**2007**	2006
Current service costs	**$9,309**	$8,051	**$786**	$340
Interest	**10,805**	9,597	**332**	239
Actual return on plan assets	**(4,094)**	(15,696)	—	—
Actuarial losses (gains) on accrued liabilities	**(24,616)**	16,230	**(818)**	2,216
Past service costs	—	—	**1,718**	—
Expense before adjustments to recognize the long-term nature of costs	**$(8,596)**	$18,182	**$2,018**	$2,795
Adjustments to recognize the long-term nature of costs				
Difference between expected and actual return on plan assets	**$(7,340)**	$5,889	**$—**	$—
Difference between actual and recognized actuarial loss (gain)	**25,552**	(15,886)	**860**	(2,206)
Difference between recognized costs and required amortization	—	—	**(1,234)**	—
Amortization of transitional obligation	**(502)**	(428)	**99**	102
	$17,710	$(10,425)	**$(275)**	$(2,104)
Valuation allowance established for accrued benefit asset	**$49**	$15	**$—**	$—
Net expense	**$9,163**	$7,772	**$1,743**	$691

The dates of the most recent and the next required actuarial valuations for funding purposes are as follows:

	Most recent valuation	Next valuation
Managers and related staff plan	December 31, 2005	December 31, 2008
Employees plan	December 31, 2005	December 31, 2008
Senior management plan	December 31, 2005	December 31, 2008
Board members plan	December 31, 2004	December 31, 2007

> **Sensitivity analysis**

The assumption regarding the increase in health care costs has a material impact on the amounts reported for other employee benefits. A one-percentage-point increase or decrease in the health care cost trend rate would have the following impact for 2007:

	Increase	Decrease
Total service costs and interest expense	**$161**	**$124**
Accrued benefit obligation	**$1,391**	**$1,073**

24) Derivative financial instruments

A subsidiary of the Mutual uses interest rate (reverse) repurchase agreements and swaps in the normal course of its risk management. The notional amounts of these derivative financial instruments and their related fair values are detailed as follows:

	2007	2006
Notional amount by maturity		
Less than one year	$**347,300**	$38,500
One to five years	**733,623**	571,891
Total	$**1,080,923**	$610,391
Fair value of assets (liabilities)	$**970**	$(2,348)

The notional amount is the amount to which the rate or price is applied to determine cash flows.

The fair value recognized in other liabilities is the estimated amount that the subsidiary would be required to pay at the end of the year to close its positions.

25) Commitments

As at December 31, 2007, the Mutual and its subsidiaries are committed under leases and service contracts expiring at various dates through 2022, to payments totalling $53,849. Minimum payments for each of the next five years are as follows: $7,118 in 2008, $6,404 in 2009, $5,616 in 2010, $4,553 in 2011 and $3,212 in 2012.

26) Contingencies

The Mutual and its subsidiaries are involved in various ongoing lawsuits resulting from activities carried out in the normal course of business. Management is of the opinion that sufficient provisions have been set aside to cover eventual losses, if any, in relation to such lawsuits.

27) Subsequent event

On January 1, 2008, a subsidiary of the Mutual acquired a 50% interest in Promutuel Vie inc. for an amount of $4,293 paid in cash.

28) Comparative figures

Certain 2006 comparative figures have been reclassified to conform to the presentation adopted in 2007.

29) Segmented information

Revenues
Business
Portfolio investments
Expenses
Operations
Participating policyholder dividends
Non-controlling interests
Changes in actuarial liabilities
Operating income by segment
Income taxes
Net income (loss) by segment
Plus: intersegment investment income
Net income (loss)
ASSETS
Portfolio investments
Intersegment investments
Others
LIABILITIES
Policyholder liabilities
Long-term debt
Non-controlling interests
Bank loans
Others
MEMBERS' EQUITY

* Consisting of other segments and intercompany eliminations.

	Life & Health		Property & Casualty		Other*		Total	
	2007	2006	**2007**	2006	**2007**	2006	**2007**	2006
	$548,445	$374,136	**$422,519**	$394,907	**$2,886**	$4,458	**$973,850**	$773,501
	98,505	99,927	**14,783**	15,106	**2,684**	327	**115,972**	115,360
	$646,950	$474,063	**$437,302**	$410,013	**$5,570**	$4,785	**$1,089,822**	$888,861
	$448,367	$334,986	**$389,322**	$378,119	**$2,304**	$3,199	**$839,993**	$716,304
	12,108	11,421	**—**	—	**—**	—	**12,108**	11,421
	3,899	736	**7,297**	5,749	**4,505**	2,181	**15,701**	8,666
	125,552	79,938	**—**	—	**—**	—	**125,552**	79,938
	$589,926	$427,081	**$396,619**	$383,868	**$6,809**	$5,380	**$993,354**	$816,329
	$57,024	$46,982	**$40,683**	$26,145	**$(1,239)**	$(595)	**$96,468**	$72,532
	(14,973)	(13,264)	**(14,707)**	(9,552)	**(983)**	(855)	**(30,663)**	(23,671)
	$42,051	$33,718	**$25,976**	$16,593	**$(2,222)**	$(1,450)	**$65,805**	$48,861
	26,259	16,977	**—**	—	**(26,259)**	(16,977)	**—**	—
	$68,310	$50,695	**$25,976**	$16,593	**$(28,481)**	$(18,427)	**$65,805**	$48,861
	$1,965,253	$1,603,594	**$331,999**	$276,808	**$13,608**	$23,164	**$2,310,860**	$1,903,566
	164,016	123,634	**—**	—	**(164,016)**	(123,634)	**—**	—
	180,946	166,866	**258,653**	246,587	**18,526**	18,632	**458,125**	432,085
	$2,310,215	$1,894,094	**$590,652**	$523,395	**$(131,882)**	$(81,838)	**$2,768,985**	$2,335,651
	$1,672,107	$1,309,504	**$—**	$—	**$—**	$—	**$1,672,107**	$1,309,504
	128	15	**—**	—	**—**	6,427	**128**	6,442
	24,526	18,820	**42,442**	41,778	**30,084**	26,009	**97,052**	86,607
	15,000	—	**—**	—	**—**	—	**15,000**	—
	112,369	180,377	**392,402**	360,130	**34,547**	42,370	**539,318**	582,877
	$1,824,130	$1,508,716	**$434,844**	$401,908	**$64,631**	$74,806	**$2,323,605**	$1,985,430
	486,085	385,378	**155,808**	121,487	**(196,513)**	(156,644)	**445,380**	350,221
	$2,310,215	$1,894,094	**$590,652**	$523,395	**$(131,882)**	$(81,838)	**$2,768,985**	$2,335,651

Risk Management

La Capitale's sense of corporate responsibility is reflected in its corporate governance practices, which uphold the highest standards of integrity, equity and transparency. Taking this responsibility one step further, La Capitale has decided to adopt an in-house Risk Management Policy.

The first risk management reports will be for 2007, and will be drafted by senior management and presented to the Board of Directors in the spring of 2008. Investment monitoring is carried out by the Investment Committee, and internal audit reports are presented periodically to the Board of Directors' Audit Committee. Compliance officials ensure that all the applicable legislation, regulations and standards are being followed. Follow-up on the standards of sound business practices is also carried out by the officers involved. Using all of these tools, the Board of Directors is able to produce an accurate overview of the risks incurred by the company.

Risk Management Policy

The Risk Management Policy came into effect on January 1, 2007, and must be followed by all officers of La Capitale Civil Service Mutual and its subsidiaries. The policy sets out a comprehensive framework for the various risks facing management, and the inherent monitoring process keeps the Board of Directors informed as to the risks assumed as well as the steps taken to control these risks.

Risk tolerance

The risk management process helps to make management aware of the various risks assumed by their respective sectors and to ensure that they are acceptable risks, or that the return generated by these risks provides adequate compensation to La Capitale Civil Service Mutual and its subsidiaries. The process also serves to eliminate certain undesirable risks that are not pertinent to the company.

Identifying the risks

The risks we analyzed were grouped into four generic categories.

Strategic risks: Risks related to the growth of the organization, our business plan, planning, acquisitions, coordination between company sectors, etc.

An analysis of the strategic risks is essential for La Capitale Civil Service Mutual to plan its business growth and to ensure that it focuses on the areas where it has a competitive edge, while continuing to offer outstanding service and asset protection to our Mutual members, in keeping with our rules of corporate governance and our code of ethics.

Risks related to insurance activities: Products offered, product underwriting, issuance, claims, distribution, etc.

A good balance must be achieved in the risks related to insurance activities. Not only do products need to meet a demand in the marketplace, they also need to be designed so that La Capitale Civil Service Mutual can adequately manage the risks and pay out claims. Product profitability is continually monitored and premium rates are revised periodically based on experience changes. Reinsurance is also subject to strict monitoring.

Financial risks: Risks involving assets, investments, financial markets, cash flow, credit, derivatives, exchange rates, matching, etc.

The investment policies set out by La Capitale Civil Service Mutual and its subsidiaries dictate the level of financial risk the company can accept with regard to its investments. The limits established in accordance with sound business and financial practices are regularly monitored, and the company ensures that it is achieving good returns in relation to the level of risk incurred. The Investment Committee is responsible for monitoring both the investment strategies and the portfolio managers. As a result, our exposure to asset-backed commercial paper (ABCP) and the U.S. subprime mortgage market has been negligible.

Operational risks: Business continuity, internal procedures and systems, technology, personnel, reputation and external events influencing our operations, etc.

The operational risk component ensures that, in the event of a crisis, La Capitale Civil Service Mutual can continue to serve its Mutual members and clients effectively through the adoption of disaster recovery and contingency plans with respect to both its systems and its teams. Succession management is also an important factor given the massive retirement of baby boomers, resulting in a possible shortage of skilled labour.

Risk Management Policy framework

The Investments department of La Capitale Financial Group is responsible for monitoring and enforcing the Risk Management Policy. Written performance reports submitted by each officer provide a process that alerts management and the Board of Directors if established risk management standards and procedures are not being followed, resulting in less than optimal decisions. Further, all the subsidiaries are required to present an overall annual performance report to the Board of Directors of La Capitale Civil Service Mutual. This periodic formal report is used to identify potential areas for improvement, and to produce an in-depth risk management report.

Responsibilities of different levels of management

La Capitale Civil Service Mutual's Risk Management Policy applies to all employees of the Group.

Each and every employee has a well-defined role to play and specific responsibilities are conferred upon management in each sector. Managers must first ensure that the risk management policy is implemented, then define guidelines, procedures and standards to be attained. It is also management's responsibility to make sure employees are aware of and apply the Risk Management Policy, and to provide them with the necessary training to do so. Managers must also ensure that risk identification is kept up to date and submit an annual performance report to the Board of Directors.

The Board of Directors of La Capitale Civil Service Mutual, representing Mutual members, remains ultimately accountable. The Board adopted the Risk Management Policy and sees to its application and follow-up. Each year, Board Directors receive and approve performance reports from senior management and ratify any required modifications or additions to the Policy.

Internal audit

Internal audit is an independent and objective function that provides the organization with assurance as to the degree of control over its operations, as well as assessing whether its activities are being administered in an efficient, effective and prudent manner. Internal audit functions include providing an evaluation of the risk management, control and corporate governance processes, as well as making any recommendations for improvement that may be required.

Conclusion

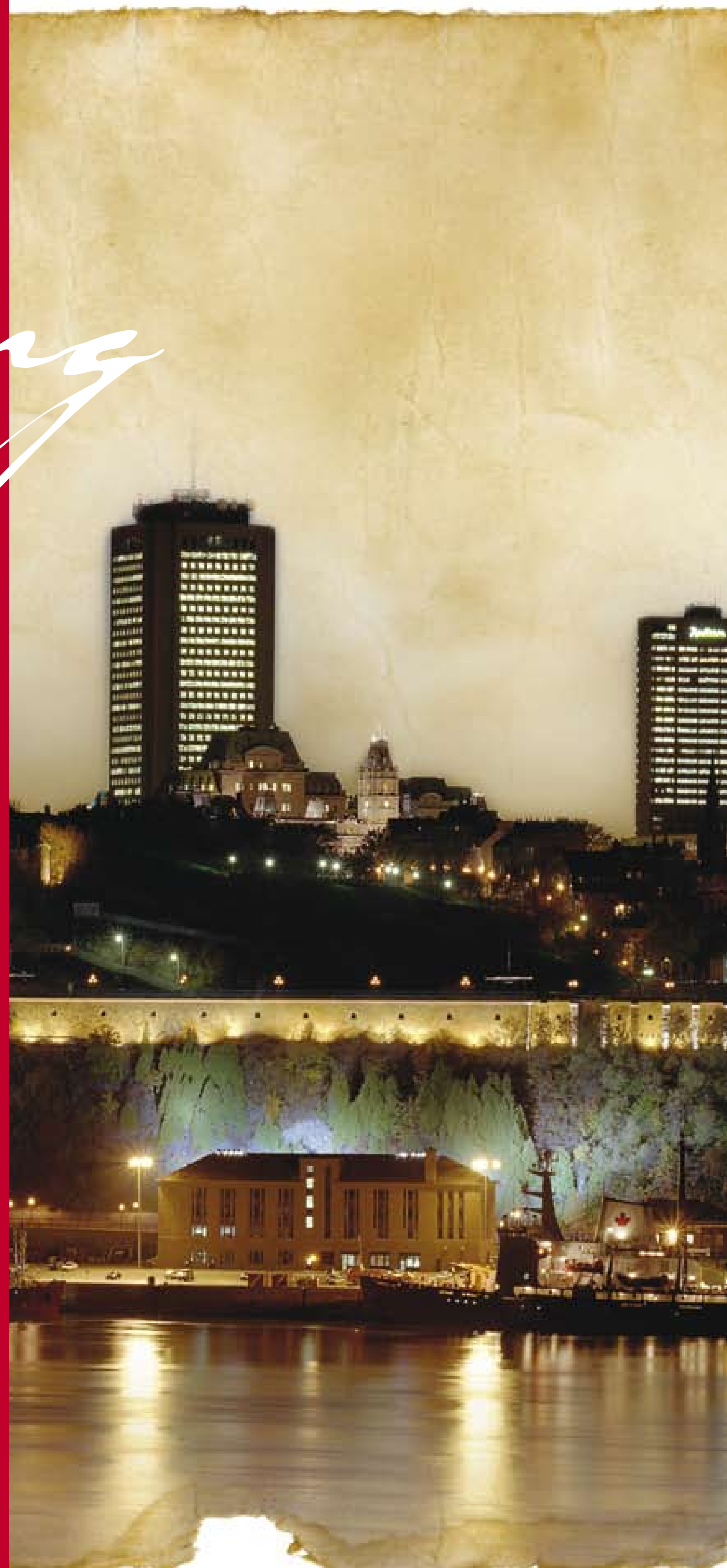
The ultimate goal of our Risk Management Policy is to support sound corporate governance and transparency in the actions taken by our companies. It optimizes the risk-return ratio of the decisions we make and ensures the sound management of our company, while demonstrating to our Mutual members that their assets are well managed and in good hands.

The Risk Management Policy and its enforcement measures will serve as an effective tool to inform the Board of Directors of La Capitale Civil Service Mutual as to the performance of the company's different business lines. This will enable the Board to carry out its mandate on behalf of Mutual members as accurately and effectively as possible.

Valuing your heritage

Quebec City has been promoting its spectacular sites, its attractions, and its warm welcome for 400 years. So it came as no surprise in 1985 that it was named a UNESCO World Heritage City. The city wears its crown well.

As a way to say thanks to our Mutual members and owners, La Capitale continues to pursue its mission and remains absolutely true to its core values. It takes concrete actions to value the work of the men and women who work so hard for our well-being.



Les photographes Kedl

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Consolidated Comparative Summary

For the year ended December 31 [in thousands of dollars]

	2007	2006	2005	2004	2003
Assets	**$2,764,893**	$2,332,761	$1,905,485	$1,870,365	$1,648,560
Total income	**$1,089,778**	$888,777	$823,322	$687,894	$690,148
Insurance and annuity premiums, premiums, fees and other income	**$973,864**	$773,514	$717,794	$599,462	$597,515
Net investment income	**$115,914**	$115,263	$105,528	$88,432	$92,633
Net income	**$53,246**	$23,807	$30,712	$30,559	$21,801
Number of contracts and certificates in force	**1,378,282**	1,112,666	1,066,795	1,018,808	857,194

La Capitale
Financial Group

In 1987, La Capitale Civil Service Mutual strengthened its strategic position by creating the holding company La Capitale Financial Group. La Capitale Financial Group is responsible for the organizational development of the parent company, which optimizes the coordination of operations across its nine subsidiaries while allowing each subsidiary to maintain its own independence. The Group also maintains controlled growth, both within Quebec and across the rest of Canada.

Board of Directors

Jean-Yves Dupéré, M.Sc. (C)
Chairman of the Board and Chief Executive Officer

Roland Guérin
Vice-Chairman

Jacquelin Bergeron

Dominique Dubuc

René Rouleau

Robert St-Denis
President and Chief Operating Officer
La Capitale Financial Group and
Life and Health Insurance Sector

John Strome, FCIP
President and Chief Operating Officer
Property and Casualty Insurance Sector

Officers

Jean-Yves Dupéré, M.Sc. (C)
Chairman of the Board and Chief Executive Officer

Robert St-Denis
President and Chief Operating Officer
La Capitale Financial Group and
Life and Health Insurance Sector

John Strome, FCIP
President and Chief Operating Officer
Property and Casualty Insurance Sector

Hubert Auclair, LL.B.
Corporate Secretary

Marcel Bélanger, I.S.P.
Vice-President, Technology

Lucie Garneau, CA
Vice-President, Human Resources
and Organizational Development

Pierre Grenier, CA
Vice-President, Real Estate Investment
and Special Projects

Simon Jean, B. Admin
Vice-President, Communications and Marketing

John Kirouac, CA
Vice-President, Finance

Michel Lévesque, FSA, FCIA, CFA
Vice-President, Investments

Alain Roch, B.A., LL.B
Vice-President, Legal Affairs

Robert St-Denis
President and Chief Operating Officer

The Year in Review

In 2007, the Life and Health Insurance sector recorded very strong growth in premium income, combined with improved profitability. Also, for the first time ever, its products and services were marketed Canada-wide thanks to the acquisition of Penncorp Life Insurance Company at the end of 2006, and the important strides made by La Capitale Insurance and Financial Services outside Quebec.

In tandem with these achievements, La Capitale fortified the business relationship that exists between its Life and Health Insurance sector and another Quebec-based mutual by purchasing 50% of the shares in Promutuel Life in December 2007. This agreement allows both companies to pool their resources and benefit from one another's strengths. With our expertise, for instance, our partner will be able to enhance its product line; in return, La Capitale will have access to a vast distribution network that includes over 250 points of service throughout the province.

Through all of these initiatives, we are strengthening our market position for the greater benefit of our Mutual members.

Accelerated growth

In 2007, all of our business lines experienced stronger growth than one year earlier.

Sales of individual life insurance by La Capitale Civil Service Insurer and La Capitale Insurance and Financial Services, for instance, grew by 21%. Premium volume for our Penncorp subsidiary reached $74.8 million at the end of the year. In individual savings, our portfolio now totals some $568 million, an increase of 11.9% over 2006, and in group insurance, sales were up by a breathtaking 134%.

We are pleased to note that in Quebec, even with our network of independent brokers more than doubling its sales in the span of one year, more than 86% of our new individual life insurance and savings business came from within the public sector. For group insurance business, this percentage is nearly 75%. These results illustrate the strong ties that we are proud to share with public service employees.

When this kind of steady growth occurs year after year, the need for technological and administrative change is not far behind. The purpose behind all this change continues to be preserving the superior quality of our service and meeting the ever-growing needs of our Mutual members and clients. It is with this in mind that, in 2007, we invested close to $8 million in technological infrastructure and IT development for our Group Insurance division. We plan to continue these investments in 2008 to ensure that we remain in step with the needs of our clients.

Our credit insurance product launched in 2006 generated over $7 million in sales by the end of its first full year. This new line of business was extremely successful with 300 automobile dealers throughout Quebec.

In the second half of 2007, we began marketing our group insurance products in Ontario, and the results are already looking highly promising. We are anticipating sales of around $10 million in premiums for this province in 2008.

Our investment in AGA Financial Group has proven to be very profitable, with an excellent rate of return, and income growth of 11.2%.

The acquisition of Penncorp at the end of 2006 required a great deal of integration work throughout the last year. From a distribution standpoint, we made the entire range of life and health insurance products offered by La Capitale available to Penncorp agents. Similarly, the financial security advisors at La Capitale now have access to Penncorp's products. This provides both of these subsidiaries with new insurance solutions, in addition to expanding their business opportunities. We also transferred certain administrative and customer service functions in order to meet specific client needs in each province more effectively. Everything is now in place for our investment in Penncorp to achieve its full potential.

New products and services

Once again this year, the Life and Health Insurance sector found innovative ways to meet the needs of our Mutual members and clients more effectively.

Following the announcement of the pay equity settlement for Quebec public service employees, we promptly set up a vast information program for the employees in question. With our in-depth knowledge of public sector employee plans, we were able to help a good many people use their lump sum settlements wisely. The speed and efficiency with which we were able to assist these individuals earned us a great deal of praise. We are always proud when we can put our expertise and resources to work for our Mutual members, who continue to be the very core of our existence.

In individual insurance, we enhanced our product line with *The Provider*, a unique type of life insurance contract. In the event of death, this innovative new product pays a fixed monthly benefit rather than a lump sum amount. Based on a simple budget analysis, insureds can accurately determine the exact amount their family will need every month to maintain their financial stability.

We also enhanced our savings products with the addition of some new Actively Managed Index Accounts. These accounts are very attractive investment vehicles offered in cooperation with two of the top mutual fund managers in Canada: AGF and Dynamic Funds.

On the Group Insurance front, we once again focused our efforts on our innovative health and wellness program *Good for you!*, which promotes physical activity and healthy lifestyle habits. We firmly believe that prevention is the best way for both the employer and the insurer to reduce the costs related to absenteeism and illness.

Financial results

The company's Life and Health Insurance sector ended the year with total premiums of $548 million, an increase of 47%, and net income after tax of $42 million, which is $8.3 million higher than the previous year.

Investment income reached a total of $98.5 million.

In spite of some significant investments in information technology, including close to $2 million recorded as additional expenses, we succeeded in reducing our unit cost ratio in the Group Insurance division.

In terms of mortgage loans, our total portfolio under management is now $1.1 billion, of which $28 million was granted in 2007 in the form of commercial loans. It is important to note that 22.4% of our new loans are protected by mortgage insurance issued by La Capitale.

Following the implementation of the new accounting standards, and in accordance with the provisions regarding financial instruments set out in Chapter 3855 of the Canadian Institute of Chartered Accountants (CICA) Manual, we had to make a significant adjustment to equity in order to accurately reflect the market value of our assets. This consolidated adjustment amounts to some $43 million.

Human resources

As at December 31, 2007, there were 1,191 employees and managers working in the Life and Health Insurance sector, 46 more than in 2006.

The financial results presented earlier could not have been achieved without the invaluable contribution of our employees, who, in a demanding environment of accelerated growth, intensified their efforts while demonstrating an exemplary degree of openness and adaptability. Their commitment is definitely worthy of recognition. In addition, many employees enrolled in various training sessions offered by the company or by outside institutions. We are especially proud of how many of our employees in Quebec enrolled in courses to upgrade their English language skills. Similarly, nearly half of all Penncorp employees voluntarily enrolled in French language courses. This strong interest is in keeping with our Canada-wide development goals.

In order to become a better corporate citizen from an environmental and sustainable development perspective, La Capitale has created a special committee made up of employees from all the group's subsidiaries. This *Eco-Committee*, whose mandate is to improve our management and consumption practices, has carried out a number of awareness campaigns. The impact of its efforts can already been seen in all components of the group.

Additional activities

La Capitale MFQ Real Estate Management headed up two major initiatives in 2007. The first was the expansion of the Au Cœur du Bourg Residence, a retirement home where 36 new units will be built, offering 26,000 sq. ft. of additional space. The second was the construction of a new 170,000 sq. ft. office tower at the Delta complex in Quebec City. Some major renovations will also be carried out on the two existing towers. The work is scheduled for completion in the spring of 2009. In the context of this initiative, La Capitale also adopted a new guideline whereby any new construction must now consider the environmental impact and follow a sustainable development approach. As a result, the new Delta office tower will be built in accordance with the criteria for obtaining *LEED* certification.

As for La Capitale Financial Management, in 2007 it divested itself of its Corp-Rate activities.

Outlook for 2008

2008 will mark the last phase of our three-year strategic plan. By the end of this year, most of the goals set out in the plan will have been achieved, and in some cases even surpassed.

Work has already begun on our 2009-2011 strategic plan, which will be announced in the fall. Not only will this plan consider the current business environment, it will also take into account four main factors:

> The North American economy
> Demographics
> Our evolution in the Canadian marketplace
> The succession plan in place within our companies

For 2008, we are once again anticipating higher organic growth than the market. Factors such as fluctuating exchange and interest rates and the general uncertainty that can win over certain markets will have to be monitored closely since they can have a direct impact on our profitability. Overall, however, we remain very optimistic for 2008.

In conclusion, we would like to thank everyone who contributed to these outstanding results: our employees at all levels of the company, our financial security advisors, our Mutual members and our clients. I would also like to thank the members of the various boards of directors of the subsidiaries for their unconditional support, constructive input and solid recommendations. On behalf of the members of our executive committee, and on my own behalf, I would like to take this opportunity to express our sincere gratitude.

Robert St-Denis
President and Chief Operating Officer

Sector Profile

La Capitale
Civil Service Insurer

At the centre of La Capitale Financial Group is La Capitale Civil Service Insurer, which has provided value-added financial products to ensure the well-being of Quebec's public administration employees for close to 70 years. La Capitale Civil Service Insurer remains the logical partner of choice for the clientele it was originally created to serve, having developed unique expertise and knowledge in terms of life and health insurance, savings and investments, mortgages and personal loans. Its teams of specialists design flexible, beneficial financial solutions that are tailored to clients' needs. And to simplify the payment of premiums, it also offers an exclusive payroll deduction privilege to some 600,000 civil service employees working in 800 institutions across the Quebec public and parapublic sectors.

Products and services offered

> Individual life and health insurance
> Investments
> Mortgage loans and lines of credit, personal loans

La Capitale
Insurance and Financial Services

La Capitale Insurance and Financial Services is a wholly owned subsidiary of La Capitale Civil Service Insurer. It provides group insurance products to clients in the public and private sectors, and also distributes and manages the provision of individual insurance products by various financial services firms.

Since it was founded in 1989, this subsidiary has become renowned for its innovative, proactive approach to workplace attendance management and prevention and the truly personalized service it provides to insureds.

Products and services offered

> Life, health and disability insurance
> Critical illness, dental care and vision care insurance
> Travel and trip cancellation insurance
> Credit insurance
> Employee assistance program
> Legal access insurance
> Home care and assistance services
> Administration software
> Health insurance claims profile
> Workplace attendance management
> Online administrative services
> Health spending account
> *Best Doctors* Assistance Service

Penncorp
Life Insurance Company

Since 1971, Penncorp Life Insurance Company has been one of Canada's leading specialty accident and disability insurance providers. It offers products and services primarily to the self-employed, small business owners, affinity groups and other individuals.

Penncorp, whose Head Office is in Mississauga, Ontario, has a network of some 200 career agents and has branch offices and field representatives in every province. From coast to coast, thousands of Canadians rely on Penncorp for customized long and short term disability, hospital care, accident, critical illness and life insurance solutions.

Products and services offered

> Short and long term disability insurance
> Hospital care insurance
> Critical illness and cancer insurance
> Accident insurance
> Life insurance

La Capitale Financial Services

La Capitale Financial Services is a financial services firm dedicated to serving the needs of those who work in the Quebec public service by helping them to get the very best coverage when it comes to financial protection. By specializing in this market, La Capitale Financial Services has developed unparalleled expertise and understanding of the needs of government employees, as well as unique tools to establish precise financial projections.

Those who work in the public service can take advantage of the services of some 180 financial security advisors across Quebec, directly in their workplace, to benefit from the value-added financial products and services La Capitale offers to them and their families. Through its network of financial strategists, La Capitale Financial Services stands by its clients by providing personalized solutions that help to build, protect and enrich their estates.

Products and services offered

> Term, whole and universal life insurance
> Health, long term care and critical illness insurance
> Registered and non-registered savings products (e.g.: RRSP, RESP)
> Investment and segregated funds
> Car, home and legal access insurance referrals
> Mortgage loans and lines of credit, personal loans
> Carte Capitale (Budget-discount card)
> Financial situation analysis
> Personalized financial planning
> Mid-career sessions
> Retirement preparation sessions

AGA Financial Group

AGA Financial Group began as André Gingras and Associates, a firm specializing in providing consulting and administration services for group insurance and pension plans. Renowned across Quebec for its group insurance claims management and payment practices, AGA Financial Group has 90 employees, more than 1,700 clients and reports an annual premium volume of close to $126 million.

Products and services offered

> Brokers in group insurance and annuity plans
> Consulting and administration services for group insurance and pension plans

La Capitale MFQ Real Estate Management

Operating within La Capitale's Life and Health Insurance sector, this subsidiary is responsible for implementing the Group's real estate strategy and managing its real estate holdings across Quebec. With assets of some $180.5 million in diversified commercial and residential sectors, including offices and retirement homes, La Capitale MFQ Real Estate Management owns approximately 1.1 million sq. ft. of property and manages some 354 housing units. Active in the construction and office leasing and layout markets, it also provides third party building management services and commercial mortgage financing.

Products and services offered

> Real estate management
> Commercial mortgage management
> Green buildings
> Quality rental management services

Key Facts and Figures

> Net income after tax of **$42 million**.

> **21% increase** in overall individual insurance sales.

> Savings and investments portfolio **up 11.9% to $568 million**.

> **More than 86% of new business** in individual life insurance and savings generated within the public sector.

> **Major group insurance investments** in technological infrastructure and IT development.

> **$262 million** in new mortgage loans disbursed, bringing the **total portfolio under management to $1.1 billion**.

> **Construction begins** on Delta 3 building with a view to obtaining coveted *LEED* certification.

Officers

Senior Management

Robert St-Denis
President and Chief Operating Officer

Corporate Actuarial

France Déziel, FSA, FCIA, CA
Vice-President and Appointed Actuary

Legal Affairs

Alain Roch, B.A., LL.B
Vice-President

Group Insurance

Mario Cusson, CA, MBA
Vice-President

Marcel Bilodeau, FSA, FCIA
Vice-President, Special Projects

Patrick Bolduc, ASA, FLMI, ACS
Senior Director, Administration

Chantal Brisson, B.A.
Senior Director, Claims Management

Richard Fecteau, FSA, FCIA
Senior Director, Actuarial

Jacques Tardif
Vice-President, Sales and Marketing

Individual Insurance and Annuities

Steven Ross, C. Adm.
Executive Vice-President

Éric Marcoux, FSA, FCIA
Vice-President, Operations
and Sales – Public Sector

Raymond Rivest, BComm., CLU, F. Pl.
Vice-President, Sales – General Agent Channel

Sylvie Chartrand, RLU, F. Pl.
Senior Director, Sales

Michel Lafrance, FSA, FCIA
Senior Director, Actuarial

Julie Plante, FLMI
Senior Director, Administration
and Customer Relations

Lorne Brennan, RLU
Regional Director
East Regional Financial Centre

Christian Breton, RLU
Regional Director
South-West Regional Financial Centre

Alain Legault, MBA
Regional Director
North-West Regional Financial Centre

Pierre Maltais
Regional Director
Saguenay – North Shore Financial Centre

Finance

John Kirouac, CA
Vice-President

Annie Larochelle, CA
Senior Director

AGA Financial Group

Michel Marcaurelle
Executive Vice-President and Chief Executive Officer

Real Estate Investment and Special Projects

Pierre Grenier, CA
Vice-President

Juliano Faleschini, B.B.A., C. App., C. Adm.
Senior Director, Real Estate Management

Jean-Guy Larochelle, CGA
Senior Director, Material Resources

Penncorp

Steven Ross, C. Adm.
President and Chief Operating Officer

Lynn Grenier-Lew, FSA, FCIA, MAAA
Vice-President, Operations

Eli Pichelli, MBA, CLU
Vice-President, Sales and Marketing – Career Channel

Neil Brown
Senior Director, Finance

Scott Hunt
Senior Director, Underwriting and Policy Services

Mark Turkiewicz
Senior Director, Claims

Mortgages and Personal Loans

Christian Dufour, FSA, FCIA
Senior Director

Human Resources and Organizational Development

Lucie Garneau, CA
Vice-President

Shirley Brown, B.A.
Senior Director

Technology

Jocelyn Garon
Senior Director

Information Technology

Francine Landry
Vice-President

Gilles Beaumont, PMP
Senior Director, IT Development
Group Division

Raymond St-Gelais
Senior Director, IT Development
Individual Division

John Strome
President and Chief Operating Officer

The Year in Review

2007 was an outstanding year of continued growth and profitability for our Property and Casualty Insurance Sector. In spite of the sustained competitiveness of the Quebec property and casualty market, this year's results surpassed those of 2006.

Consolidated net income for 2007 reached $33.3 million—an $11 million increase over the net income of $22.3 million reported in 2006.

La Capitale's assets were also up, growing by 12.8% to reach $591 million.

La Capitale and L'Unique are the insurers of choice for consumers, and our strong performance creates quality employment and enrichment for future generations in Quebec.

Consolidated operating results

Property and casualty insurance showed marked overall growth of 8.6%, with a total premium volume of $473 million. To achieve this outstanding growth, our member companies drew on reputation, rate strategy, product offering and distribution networks to attract a large number of consumers. This performance is in line with the strategic directions laid out at the beginning of 2007.

We would not have achieved these results without the improvement in our loss ratio, which went from 67.7% in 2006 to 63.8% in 2007. Our expense ratio stood at 28.4%, yielding operating income of 7.8% in 2007 as compared with 4.2% in 2006.

Auto insurance

Once again this year, our Auto Insurance line posted excellent results, with premium volume up by $7.2 million. This line of business has been consistently profitable, and we have adjusted rates downward in reflection of these strong results and for the benefit of our clients.

2007 saw the finishing touches made to *RV Solutions Insurance®*, La Capitale's recreational vehicle (RV) insurance program. Launched in 2006 with motorcycle, ATV and snowmobile coverage, the program has now been broadened to include coverage for watercraft, motorhomes, travel trailers and stationary trailers. This makes La Capitale the first direct response insurer to offer stand-alone insurance coverage for all types of recreational vehicles. This innovative insurance program was made possible with the help of select partners who enabled La Capitale to penetrate this new market. Program pluses include free legal and roadside assistance services. Snowmobile, ATV and boating enthusiasts greatly appreciate the free *AirMédic* family membership card that comes with their coverage. The warm reception of *RV Solutions Insurance®* by the market is attributable to the quality of the insurance program and to the solid reputation enjoyed by La Capitale across Quebec.

Automobile theft remains a major problem which we continue to battle. It has a significant impact, representing some 17% of Auto Insurance claims paid. The frequency of losses due to auto theft did however fall by 20% in 2007, which points to an improvement in the situation over previous years. Based on the positive impact of our prevention program, we will invest close to $2.5 million in preventive measures and programs in 2008.

Home insurance

Our Home Insurance line enjoyed excellent net growth of $11.4 million—a marked improvement over 2006 and 2005 results. Underpinning these strong results are sound underwriting policies designed for the markets we serve and prevention campaigns which are extending their reach to increasing numbers of consumers.

While water damage claims represented close to 40% of claims paid, this was nonetheless down from 48% in 2006. This decline in claims is also linked to the notable absence of natural disasters.

Home Insurance reached profitable levels in 2007, in line with expectations under the turnaround plan we presented three years ago.

Commercial insurance

Our Commercial Insurance line also had an excellent year with breathtaking growth of 30.2%, an improvement over the already exceptional growth rate of 20% posted in 2006. Premium volume reached $28.7 million. In addition to posting continuous growth, this line of business is profitable.

During the year, we developed a new affinity group insurance program for automobile dealerships and home improvement centres. We also successfully pursued expansion in the specialized professional and fiduciary liability markets.

Legal access insurance

Our Legal Access Insurance coverage remains in high demand with our clients. Laws and regulations are becoming more and more complex and individuals are increasingly determined to assert and defend their legal rights. Legal Access Insurance gives insureds access to a team of competent, experienced lawyers at minimal cost. We handled over 13,704 Legal Access Insurance files in 2007.

Our assistance services

At La Capitale, we do so much MORE than simply pay claims—we work with our clients to serve their needs, and what better reflection of this than the success enjoyed by the assistance services we offer.

CAP Roadside Assistance is offered free of charge to all of our clients with Auto, Home and Legal Access Insurance policies. The service is also offered at no charge to motorcycle, motorhome and travel trailer policyholders. Our 2007 results testify to the effectiveness of the program, with nearly 40,000 service and assistance calls logged.

CAP Home Assistance is a referral service available free of charge to all of our Home Insurance policyholders.

There was a significant increase in services provided by CAP Legal Access Assistance, which gives our clients exclusive access to lawyers employed by La Capitale General Insurance.

These assistance programs are always much appreciated by our clients.

Maxi-Privilege

Since 2004, all La Capitale policyholders who are public service employees or retirees enjoy $5,000 of free coverage under the *Maxi-Privilege* accidental death insurance policy. Since it was launched, some $175,000 has been paid out in claims. The program was created to recognize the contribution of the members of La Capitale Civil Service Mutual to the establishment of our Company in 1975.

L'Unique General Insurance

L'Unique gives brokerage firms a viable solution to the consolidation of property and casualty insurance markets. 2007 results were impressive, showing marked improvement over 2006. With sales figures up 16.7% and a net income of $5.7 million, the company's vitality is clear.

Commercial Insurance saw accelerated development. This line of business pursued growth both in specialized fields where it developed particularly strong expertise in surety and credit insurance and in the traditional property and automobile products tailored to a range of businesses.

We are proud of our excellent relationships with our partner brokerage firms who tell us that they appreciate the quality products and services we offer. Over the past year, we implemented a technology blueprint and completed system integration for our Home Insurance line of business. The implementation phase for our Auto Insurance line will get underway in 2008.

Distribution channels

We offer our products and services to the consumer in a variety of ways: two call centres, 22 branch offices and 140 agencies assure our presence across Quebec.

More and more clients are turning to the Web for their insurance needs. In 2007, our online quotations initiative made major strides through sales promotion initiatives for all automobile and most RV insurance quotations requested online.

L'Unique General Insurance products and services are available to consumers through our partner brokerage firms.

Competence, experience and commitment

For over 30 years, our business actions and energies have focused on meeting and surpassing the needs of our clients. We are relentless in our pursuit of excellence and the client is always our first priority.

Our success is due first and foremost to our employees. Our passion for excellence would not be possible without the personal commitment of the men and women who make up our member companies. For this reason, we have always paid particular attention to their needs.

Our relationship with our employees is based on our values and on our three "R" policy: Respect, Recognition and Responsibility (empowerment). These values and principles are reflected in our culture, which encourages employee development and favours promotion from within. Over the past five years, in reflection of this commitment, 93% of our promotions were made from within and 100% of our new or replacement management positions were filled from within.

Our social involvement

As a corporate citizen, we take our social responsibility seriously. La Capitale takes part in a number of social, economic and environmental activities in various ways.

Our social commitment was underscored by the invitations we received from the *Fondation du Cégep de Ste-Foy* and the *Fondation du Cégep du Vieux Montréal* to serve as honorary president of their respective fundraising gala evenings. We financially supported a number of scholarship programs as well as the Leadership Award. In addition, we were delighted to encourage our staff to take up the Health and Wellness Challenge, in which employees were encouraged to take regular walks over a six-week period to stay in shape.

Our employees are also active members of CADD (Quebec Casualty Direct Writers Corporation), the Insurance Bureau of Canada (IBC) and the GAA (*Groupement des assureurs automobiles*).

In late 2007, La Capitale General Insurance became a key partner of the *Fondation de recherche en sciences infirmières du Québec* (FRESIQ) by making a five-year commitment to offer financial support.

Furthermore, as part of Road Safety Year, La Capitale decided to team up with a company named Guardian, which put together the *Apprentice* support program for young drivers aged 16 to 24. Because we attach the greatest importance to the safety of our customers and young drivers, La Capitale offers great rates to customers who are eligible for the *Apprentice* program.

Innovation: moving forward and setting ourselves apart

We strive tirelessly to enhance our processes to serve customers better. With this firmly in mind, La Capitale developed a tool for road claim adjusters: a notebook PC supporting a paperless, one-tool approach for settling claims on the road. This new innovative tool earned us an award of excellence at the *OCTAS*, a major IT awards gala, in the “Organizational Process Transformation” category for organizations with 250 employees or more. Our imagination and specialized IT knowledge makes La Capitale a true leader in IT.

Our unwavering dedication to putting people first, one of our core mutual values, fosters excellent customer relationships. Our value-added products, such as identity theft, legal access and zero-deductible coverage, were developed not only to guarantee that our customers are covered financially, but also with their well-being and quality of life in mind.

In 2007, La Capitale introduced a bold new slogan: *So much MORE than insurance!* This sums up our philosophy and our drive to serve the population’s specific insurance needs by continually striving to give it more!

Our future

Over 50 major development projects were launched in 2007 and we will be showing the same drive in 2008. We wish to increase our market share among English-speaking Quebecers and expand our line of products and offer them through our distribution networks, whether it be our branches, agencies, L’Unique brokers or online.

La Capitale General Insurance and L’Unique General Insurance enjoy excellent market share throughout Quebec. From a long-term growth perspective, we are seriously considering the possibility of making inroads across the rest of Canada.

Teamwork is the watchword

Serving our clients is our primary concern and source of motivation, and we thank them for their continued trust, year in and year out.

We extend our heartfelt thanks to some 1,000 Property and Casualty Insurance employees, as well as our affiliated agents, for their commitment and hard work in driving the success of our businesses. We sincerely appreciate their contribution and owe them a great debt of gratitude. We would be remiss in not acknowledging our close ties with our various business partners and, in particular, the brokers at L’Unique.

Our management team and Board of Directors play a crucial role, and we thank them for their invaluable collaborative spirit, day-to-day support and expert advice.

We are poised to capitalize on the challenges we see ahead in 2008. And the launch of a new program tailored to young families will show our customers yet again that La Capitale offers *So much MORE than insurance!*

John Strome
President and Chief Operating Officer

Consolidated Comparative Summary

For the year ended December 31 [in thousands of dollars]

	2007	2006	2005	2004	2003
Assets	$**590,656**	$523,413	$489,528	$440,444	$327,064
Shareholders' equity	**198,254**	163,269	147,815	132,544	111,265
Gross premiums written[1]	**472,452**	435,024	410,772	328,153	281,771
Net income	**33,273**	22,342	21,444	26,473	20,438
Loss ratio	**63.8**%	67.7%	68.8%	65.5%	65.9%
Expense ratio	**28.4**%	28.0%	27.2%	26.1%	25.9%
Number of insurance policies in force	**794,569**	757,750	734,764	681,286	510,729

1 Before premiums assumed and ceded to the Risk Sharing Pool of the *Groupement des assureurs automobiles*.

Sector Profile

La Capitale General Insurance

Since it was established in 1975, La Capitale General Insurance has become one of Quebec's leading home and auto insurance companies. Originally founded in response to the needs of owner members of La Capitale Civil Service Mutual, the company has maintained its commitment to public service employees while extending its product offering to the general public, establishing a network of 22 branch offices across Quebec to remain close to its clients and better serve their needs.

With some 800 employees, La Capitale General Insurance is a direct response insurer that distributes its products without intermediaries. As well as offering home and auto insurance products, it has diversified into legal access insurance, insurance for private companies and the self-employed, travel insurance as well as insurance for recreational vehicles.

La Capitale General Insurance also invests in ways to further assist its clients. That is why it has rounded out its line of products by creating the *CAP Priority Assistance* program—a complimentary service that provides clients with exclusive roadside, home and legal access assistance.

Products and services offered
(Direct distribution)

> Auto insurance
> Recreational vehicle insurance (motorcycles, snowmobiles, ATVs, boats, motorhomes, travel trailers and stationary trailers)
> Home insurance
> Legal access insurance
> Professional liability insurance
> Insurance for private companies and the self-employed
  – Income replacement protection
  – Automobile dealerships
> Travel insurance
> Assistance programs
  – CAP Roadside Assistance
  – CAP Home Assistance
  – CAP Legal Access Insurance

L'Unique General Insurance

Established in 1978, L'Unique was acquired by La Capitale General Insurance in November 2004. L'Unique thereby became a wholly Canadian company, ensuring the stability and permanence of its operations. It continues to be independently managed and distributes its products through a network of more than 300 independent brokers. Both companies' intimate knowledge of the Quebec market is a key factor in their ability to offer innovative products and tools to their broker network. L'Unique's advanced computer systems provide user-friendly access to brokers, and its *Le Guichet Unique* electronic data interchange system allows brokers to communicate in real time with L'Unique over the Web. With an assistance program available on a 24/7 basis, the majority of claims submitted to L'Unique are settled internally. Some 120 employees work at L'Unique's Head Office in Quebec City and its branch office in Montreal.

Until recently, L'Unique distributed only individual insurance (home and auto). In February 2005, L'Unique began to distribute commercial insurance products. Also in 2005, L'Unique acquired Orleans General Insurance Company, which is specialized in surety bonding. L'Unique is now able to offer its brokers a diverse line of products for individuals and businesses, along with a complete line of contract and commercial bonding services. L'Unique is renowned as the leading small business insurer in Quebec.

Products and services offered
(Broker distribution)

- Auto insurance
- Home insurance
- Commercial insurance
- Legal access insurance
- Surety bonding
- Credit insurance
- Assistance services
  - L'Unique roadside assistance
  - L'Unique home assistance

Key Facts and Figures

- > **Consolidated net income reached $33.3 million**.
- > **Consolidated written premiums up 8.6%** to **$473 million**.
- > La Capitale's Commercial Insurance line reports **30.2% growth in written premiums** to **$28.7 million**.
- > **Launch of online quotations** for auto, motorcycle, snowmobile, ATV, travel trailer and motorhome policies.
- > ***RV Solutions Insurance®* product offering enhanced** by adding coverage for watercraft, stationary trailers and travel trailers.
- > **L'Unique reports 16.7% growth in sales**.
- > **Award of Excellence for organizational process transformation at a major IT awards gala**.

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President and Chief Operating Officer

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Actuarial

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Profile of Related Services

La Capitale Financial Management

A subsidiary that offers unique, original services to clients of La Capitale Financial Group. With close to 70 years' experience, La Capitale Financial Management is one of North America's leading providers of payroll deduction services for insurance and financial product premiums.

Carte Capitale is a budget-discount card offered to Quebec public administration employees and La Capitale insureds. Using payroll deduction, it is designed to help cardholders manage the family budget for savings, car expenses and municipal taxes.

Discounts and other income managed amounted to some $8.5 million in 2007.

Products and services offered

> Payroll Deduction Service
> Carte Capitale (Budget-discount card)

Officers

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Visit our website at www.**lacapitale**.com

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